Lunch Seminar Report
June 2019

NORDSIP
NORDIC SUSTAINABLE INVESTMENTS

insights

Sustainable value creation through

CORPORATE ENGAGEMENT

the editor's word

the value of engagement

There is nothing new about corporate engagement. Shares come with a voting right, and most companies have traditionally maintained channels of communication with institutional investors through their IR departments. However, in the context of responsible investing, engagement has progressively received more attention. The way investors engage has also changed and become somewhat more organised and thereby more effective.

In a world where many investments in stocks are made following a passive strategy, managers may have lost the natural link they previously had with the management of companies they have invested in. This relationship can be restored, either directly between the asset manager and the company, by appointing a specialised in-house team, or by using third party service providers who engage on behalf of their clients.

For any strategy involving more than a handful of stocks, engagement can be extremely time consuming and resource intensive. This is why it may be simply more efficient to group efforts and act in concert. But that is not all. Especially when taking into account sustainability concerns, issues may soon become technical or even ethically ambiguous. A high degree of specialisation can become a real asset when adressing issues specific to some industries.

One fine November day in Stockholm, we had the privilege to host a lunch seminar with engagement service provider GES International (which subsequently became part of Sustainalytics, in January 2019), and BMO Global Asset Management, which offers engagement services independently from its asset management products.

We found out more about the opportunities engagement can unlock for investors, how the two firms organise their engagement efforts and we examined some practical examples. Participants with a high level of knowledge about sustainable investing contributed to the discussion by sharing their own views, as well as asking insightful questions.

The key takeaway is that engagement adds a tremendous amount of value to the investment process. The information gathering obtained through more open communication channels or the long-term changes investors can inspire the company to perform may both reduce risk or enhance return. Unlike diversification, however, engagement is not a free lunch. It requires expertise and dedication.

Aline Reichenberg Gustafsson, CFA
Editor-in-Chief
NordSIP

MENU

amuse-bouche

starter

main

dessert

coffee

your experts

Tytti has ten years of experience in responsible investment and joined Sustainalytics in 2011 (previously known as GES International). As the Head of Stewardship & Risk Engagement, she is responsible for coordinating Sustainalytics' proactive and bespoke engagements, which focus on identifying the most material and topical ESG themes and through structured engagements raising standards across industries and on creating positive change on some of the biggest challenges facing companies, investors and societies.

Before joining Sustainalytics, Tytti worked as a Responsible Investment Analyst at The Co-operative Asset Management in Manchester, UK.

She holds a Bachelor's degree in Politics from Manchester Metropolitan University and a Master's degree in International Relations from the University of Manchester.

Tytti Kaasinen
Head of Stewardship & Risk Engagement
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David joined the Responsible Investment team at BMO Global Asset Management in 2017 and has over 11 years of ESG engagement experience. Prior to joining the firm David was ESG Manager at Fidelity International, responsible for their ESG integration programme, having previously held senior research positions at the governance research agencies ISS and PIRC.

David has extensive experience with European and US coverage on researching ESG topics, engaging with companies at a board/senior management level and dialoguing with policy makers. In addition he has been involved in integrating ESG themes into the investment research and decision-making processes. He has the Investment Management Certificate (IMC) from the CFA Society. He also holds a BA in Philosophy from Sussex University and an MSc in Philosophy and Public Policy from the London School of Economics.

David Sneyd
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Sustainable value creation through

Corporate Engagement

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20 November 2018

"Professional investors increasingly expect that asset managers to perform their engagement as part of the investment process."

"Over the last 30 years, particularly after apartheid, the financial industry saw a movement in ethical screening and exclusions based on product involvement," explains David Sneyd. "This idea progressively became more mainstream. In the last ten years, the integration of environmental, social and governance (ESG) considerations has taken off, and that is what the idea of the Principles for Responsible Investing (PRI) was based on and has since significantly contributed to. Incorporating ESG risks and opportunities into the stock-picking process, and fully understanding how it fits in has global application across all asset classes. Positive screening and thematic funds, such as clean tech, for instance, are other examples of products that have seen considerable development in the past ten years. Lately, impact investing has also received increasing attention."

"At BMO, we believe that engagement is an important element of a responsible investing approach that is relevant across all of these strategies. This is entering into dialogue as investors with the companies we hold, around their management of key ESG issues. An engagement process can enhance investment analysis, supporting ESG integration, particularly as disclosure and standardisation around ESG factors is lagging significantly compared to financial data. When an incident triggers reactive engagement, for example, the company's reaction and the improvement process that follows (or the lack thereof) are insights into management quality we gain from engaging, which we would not obtain otherwise."

Digging down into the different reasons that motivate engagement, Sneyd mentions three dimensions BMO focuses on: risk management, stakeholder expectations and compliance. "Risk management is about analysing if companies understand the risks they face, the influences they have, and what external factors affect them in the ESG space," Sneyd explains and mentions an interesting study. "Research has suggested that improving company performance on ESG issues may also have an associated positive impact on financial performance. We have been logging and storing data on our activity since the beginning of the 2000s, and an academic group undertook a detailed study based on BMO GAM engagement data with US companies collected over 10 years that was published in 2012 . The study suggested that over that period successful engagement was followed by a measurable positive impact on returns compared there was a measurable confirmed that alpha was generated where engagement has taken place. Research in this field is at a fairly early stage, but for us this finding is very exciting, and we think it makes sense. From a risk management perspective, the engagement process enables us to ensure that the companies that we are holding, or looking to hold, fully comprehend the risk they are exposed to. They may present a great CSR report, but how does the philosophy translate into internal activity? Is corporate responsibility something that is applied beyond this publication and throughout the business? We can often only answer these questions by talking to the company."

Why engage?

Risk Management	Identification and management of ESG factors Portfolio and fund manager monitoring
Stakeholder Expectations	Clients Public Stakeholders
Compliance	Regulatory Requirements Industry Standards

"Stakeholder expectations are that considered stewardship and engagement is simply part of being an asset manager now. Professional investors increasingly expect that asset managers to perform their engagement as part of the investment process. Alongside this, we are currently witnessing a real shift in consumer attitudes globally, particularly with generation Y. Millennials are more conscious about the consequences of their behaviour than any other generation, both regarding their consumer choices and where their money is invested. A 2016 study by Scorpio Partnership and FactSet shows that 90% of under-35 high net worth individuals expect to increase their allocation to socially responsible investment in the next five years. For over-55-year-olds the number would be only 38%. We need to take into account who our clients are now, but also who they will be in the future. They will not only ask what they are funding and where their money goes but want to know about the influence those investments allow them to have."

"Finally, we (and by extension our clients) have to comply with regulatory requirements and the best practices that are emerging. When we talk about compliance, we include a blend of regulatory and super-regulatory demands. The UN PRI plays an important role, of course, regarding active ownership. National stewardship codes are also growing in importance. Owning shares entitles an investor to some rights, but there are implicit stewardship obligations attached, which require dialogue and engagement. Interestingly, the Shareholder Rights Directive II intends to mandate disclosure of a policy on engagement by June 2019. Engagement may not become mandatory, but efforts will become increasingly visible.

Enhanced information

"The primary aspect of engagement is the impact that investors can have on companies and how they change companies," says Tytti Kaasinen. "Another facet that is often forgotten is the amount of information the engagement process can help extract from companies. This type of intelligence is often not public, and while it is not material from an investment perspective, it may be particularly useful given an investor's unique priorities or interests. Through an open dialogue with companies, investors can get back crucial information to make better-informed ESG decisions. While the premise of engagement may not be to extract data, this component should not be forgotten when we're talking about the benefits of engagements, whether reactive or proactive."

There are similarities between reactive and proactive engagement, Kaasinen explains. "Firstly, engagement is where investors can often generate a tangible impact, as opposed to through divestments or exclusions," she says. "Selling shares in a company equates to giving up on the opportunity to push the company and have conversations with the management. If it doesn't close the communication channel, it makes it more difficult. Owning shares gives more weight to engagement. Engagement, generally speaking, is in line with the fiduciary duty of investors. It is a good way of protecting the value of your assets. Of course, engagement is also an integral part of the UN Principles for Responsible Investment (PRI); hence it is a pillar of responsible investing, especially for the signatories."

Reactive Engagement

Reactive engagement is based on norms, and Sustainalytics calls this part 'business conduct engagement'. "Unsurprisingly," Kaasinen comments, "the norms we consider are rather common to most sustainable investors and include the environment, human rights, labour rights, corruption and inhumane weapons. Typically, engagement commences on a potential breach of international norms. Most often, reactive engagement starts with an incident. Something has gone wrong. These incidents generally relate to international norms, laws and conventions, or mutually agreed standards of how companies should be behaving in terms of ESG. This is why norms form the basis for reactive engagement. Another reason is that investors need to comply with international norms and therefore expect the companies to be compliant with those norms."

Evaluation

"Once an incident takes place, the process starts with establishing what has gone wrong. Then, we devise what the company should be doing, what it has already done and what is left to do. What are the shortcomings and what is the right way to address them? We can then design our engagement strategy to achieve those objectives in this particular instance, as well as, at the same time, make sure that the company becomes a more responsible and holistically managed company in terms of ESG. We thereby ensure that the company becomes a better long-term investment."

"In the evaluation stage, we determine whether the incident qualifies for engagement, in terms of magnitude and significance. We also identify if there are any particular aspects we can improve within the company in general, through initiating a dialogue as investors."

Engagement

"If we believe the incident and the company qualify, we can proceed and engage. We then initiate an ongoing, collaborative and constructive process with the companies. We do not merely send one letter and then let the company be for a year. We pursue an ongoing dialogue with a dynamic exchange of questions. We remain open and listen to the company's side of the story. We ask what they think about the situation, making sure that the company understands why we are concerned about the matter at hand, what we perceive the problem to be, and what solutions we preconise."

"We do not merely send one letter and then let the company be for a year. We pursue an ongoing dialogue with a dynamic exchange of questions."

"Sometimes, we have felt like a 'free' consultant to the company. We provide ideas and expertise in cases that they may not be familiar with. We hope to drive the companies to change and give them some of the tools they need to achieve that change. Meanwhile, we adapt to their language look at the company's perspective, by understanding its operating environment. To be taken seriously by the company, we need to be aware of the situation they are facing. We have to understand what their challenges and priorities areof operating in their business environment. We need to do our homework and research the facts, to have any chance of driving a successful engagement."

Feedback loop

"Thanks to the open dialogue we establish we obtain the evidence from the company that they have learnt from their mistake. We can confirm that they understand and recognise why something went wrong in the first place. There is a problem they need to fix and then progressively they need to improve their policies and practices to ensure it does not reoccur. As far as we are concerned, we do not set any time limit to achieve these improvements. Here is a key difference between reactive and proactive engagement at Sustainalytics. When we engage reactively, we allow the company indefinite time to remedy their issues. We are willing to engage for as long as the company needs until we are satisfied that it has become a more secure investment again. Even if none of our clients holds the shares any longer, we will continue engagement with the company until we have met the change objective because it is still a potential investment for our clients. By improving the situation, we are widening our clients' universe in acceptable, well behaved and well-managed companies."

Disengagement

"Companies may not always be as responsive as we would hope, unfortunately. Sometimes companies don't answer. Sometimes they merely answer by sending us links to their sustainability reports. Other times, they may respond in acceptable PR language, but they don't show any practical improvements or are unable to elaborate on how they implement their policies in practice. Companies may not be interested in reacting, or they may not acknowledge the problem. When a company does not respond to our engagement efforts or does not show any interest in progressing, the company's status changes to *disengage*."

"Disengagement is, by no means, a final conclusion."

"We never make any explicit recommendations to exclude a company, but a *disengage* status is an indication that the company may not be suitable for a responsible investors' portfolios. Disengagement does not, however, mean that we forget about the company entirely. We keep monitoring it, and as soon as we perceive a sign that the company might be open to changes or dialogue, we reopen the conversation. There may be several reasons for such a change, some very small. One person alone may be turning the company's attitude around in a short time. We need to keep our eyes open and make sure that we are ready to continue the process. We have witnessed this situation more than once. Disengagement is, by no means, a final conclusion."

A successful turnaround

One example Kaasinen mentions is Walmart: "It is one of our oldest cases and a great example of a long-term case. We have engaged with Walmart for 15 years. Traditionally, the company was not very open to discuss or acknowledge their problem, while in the press, everyone could see daily headlines regarding their labour relations management. Therefore, we put Walmart on our 'disengage' list for a while, until a few years ago. Now it is one of our most constructive and active engagements. The company bounced back spectacularly. They are interested in the dialogue, they are listening, asking for suggestions and they want feedback. They talk about their issues in a completely different manner. It is a pleasure to engage with them today. This case shows that engagement can be unpredictable, and that patience is part of the process. We observe, we wait, and strike when the time is right."

Incidents are conversation starters

"One of the strategies we find particularly helpful is to extract the learnings of an incident, while the matter is being exposed in the news and is highly topical," Sneyd continues. "In retrospect, these instances can be an opportunity. We can use the incident as a conversation starter with the affected company's peer group. 'How do we know you're not going to end up in the same situation in two months?' we ask."

"It is easier to fix stuff before it's broken," Sneyd adds. "When we try to educate companies, the conversation is often slightly more difficult to initiate if the company does not agree on the materiality of an issue. But when we succeed, we do obtain superior results because we try to make companies more resilient before something happens that shows how vulnerable they are in a certain aspect of their business."

Sustainalytics' Tytti Kaasinen adds: "Reactive engagement often does present affected companies with an advantage. Once companies have engaged with investors and have improved thanks to the conversations they had, they end up with higher standards than the rest of their peers who are not engaging, because they didn't get caught up in a scandal. That is a shortcoming to some extent, but it can be turned into a positive starting point. It shows how the proactive work that takes engagement to the sector level can complement the incident- or breach-related engagement. Effectively, we take the lessons we learn from one company's incident and get others to learn from it and follow the right path together."

Reporting on reactive engagement

"Reactive engagement is normally triggered by either norm violations or negative news flow. The response by companies to reactive engagement can be mixed. We try to be very transparent with our clients about the perceived success of our engagement," Sneyd says.

"To give an example of a reactive engagement process that we wouldn't consider having been entirely successful, we could discuss the case of Volkswagen. Following the scandal that broke about falsified emissions data in 2015, the company pulled up the drawbridge in terms of their willingness to engage with investors."

"The background of this story is well known, but it is a good example to showcase the work we were able to do together with the company. In 2016, after a year of trying to establish contact, we were given an audience with the chairman of the Supervisory board. We got involved with other investors and brought a joint initiative at the AGM. We also joined efforts to get the company in the Climate Action 100 initiative. We don't consider that we are quite finished yet, by any means. We very much felt that we got up a steep slope, but we are far from having cured the issue that caused the scandal in the first place. We have concluded that the company has done a lot of window dressing, and our work continues. For example, in 2018 we voted against both of the company boards because we got to the point where we needed to express our disagreement more firmly."

"To illustrate a contrasting experience, we could consider Novartis. The company has evidenced a number of issues that ultimately relate to business conduct and business ethics, which have not been uncommon in the pharmaceutical sector. Our engagement with Novartis goes back to 2006, but we focused more on responsible sales and marketing since 2014. We already had a history of open dialogue with the company, and they were very responsive to connecting us with the right people in the company to implement change. Talking to the right person, we have a chance to discuss solutions. Together with the company we focused on where employee evaluation and incentive structures were driving particular behaviours, and after several years of dialogue and incremental improvement we were pleased to note that recently they announced that business performance data relating to responsible sales and marketing will be formally considered within their compensation scheme. We can be proud of the progression of this case."

Proactive engagement is what Sustainalytics calls 'stewardship and risk engagement'. "Luckily companies are not often confronted with the kind of issues that warrant reactive engagement," Kaasinen continues. "The majority of cases in your portfolios and our client's universes are never caught in the headlines for breaches of international norms. The lack of a problem does not prevent us from engaging, however. We find plenty of risks that have not yet materialised but that the company can remedy."

"We identify these risks at the sector or geographical level or on an individual company basis. Typically, we target significant risks that the company should address proactively. On the one hand, they may avoid risks, which may cause disruptions in their operations in the future. On the other hand, companies may identify opportunities to profit from. In general, we approach companies to ensure that they are aware of positive or negative developments around them."

Identifying important trends

"Identifying the issues to engage on is paramount. We target global trends that are 'hot', topical and material for companies. Business relevance is key. To a certain extent, proactive engagement is 'reactive' in that we address current changes in the business environment."

"When we have found an appropriate topic, a worldwide trend or company risk, we perform a background assessment to identify specific issues that need to be addressed. We analyse how a theme can pose particular hazards at the company level, how it will manifest itself practically, and what the solutions should be. We then select the appropriate companies to initiate engagement."

A broader reach

Proactive engagement broadens the reach. "Reactive engagement is often company-specific. When we look at themes for proactive engagement, we consider entire sectors or regions. We pick around 20 companies to engage with. We thereby may impact an entire sector positively. We always choose both leaders and laggards within a given area, so that we can learn from the leaders and take the best practice to the laggards."

"We find plenty of risks that have not yet materialised but that the company can remedy."

"We inform our thought process while obtaining practical examples we can take forward, or use as a 'silent weapon' against the laggards who might argue that it is too tricky or costly to address the issues we talk about. Looking at the entire spectrum within a sector allows us to understand the problem better. That way, we provide our clients with more than the sum of the parts, as we leverage on our engagement and increase our expertise."

Identifying specific objectives and measuring them

"Just like in reactive engagement, defining precise goals is the key to successful proactive engagement. We need to set our targets and our process from the onset. We develop a methodology and determine a clear timeline. For thematic engagements, we give ourselves three years. We established that it is a realistic timeline for having the chance to have an impact on a company while keeping within the scope of a specific project."

"Having a clear timeline helps us develop appropriate objectives which can be achieved within three years. We can measure our progress and measure the impact of engagement against a KPI framework developed for each theme, where we can attribute a numeric value to each indicator. We perform a semi-annual report, and we can see every six months how we have progressed with specific figures. We know in percentage how we compare with the final target. Investors appreciate that ability to see the impact and demonstrate it, especially in numeric terms."

Thematic Engagement

One way BMO's team plans engagement work is around thematic projects, which may last a single year or less, or may carry on for several years in some form. "We have seven high level engagement themes which are ongoing areas of focus for us," says Sneyd. "For example environmental standard, labour standards, public health and human rights, business ethics and corporate governance. Each year we develop a range of more topical projects linking to one or more of these high-level engagement themes. In 2018 three of these projects have related to the environment (climate change, agriculture and biodiversity and ocean plastics), three to the social dimension (nutrition, modern slavery and ESG disclosure at mid-cap companies) and the last one (data privacy & security) relates to governance. The reason for development of each of these projects could be something that we see as an emerging risk, or an issue that we believe is poorly addressed by one or more sectors. Once we identify an issue, we determine what the theme is, which companies we should target, what we should be asking for, and we put these on our agenda for the year, after we consult our clients. Some of the projects remain from one year to another, and we add new ones as they come up. Some issues are relatively quick to resolve, while others are slow burners."

"In 2019, two projects we are adding relate to the rise of antimicrobial resistance and climate change issues in marine transportation," Sneyd continues. "Identifying long-term or short-term goals is a good process to keep us moving forward as a team. Alongside this project-based engagement, we come up with a list of about 60-80 companies every year, where we believe there may be something company-specific that we want to address through engagement. With this pro-active engagement we set ourselves objectives and set about fulfilling them."

"Currently, we target 12 topics, which we believe are particularly relevant for both companies and investors," says Tytti Kaasinen. "Climate transition, food supply chain, sustainable seafood, taxation and water are some of the most important ones. Some of the themes have surfaced through our reactive engagement, but some do not. We find that our theme-based approach is complementary to addressing ESG issues broadly. As an investor, you don't have to wait for something to go wrong or a report to come up with a specific breach before addressing the food supply chain, working conditions or water risks. These are ongoing issues that companies are facing by operating."

A closer look at the SDGs

SDG mapping

Sustainalytics has mapped the thematic engagement themes against the Sustainable Development Goals. "We want to make sure that we are choosing themes through which we will contribute to the achievement of the 2030 agenda," Kaasinen explains. "Both companies and investors are increasingly interested in what the SDGs mean for them. This way, we can choose relevant themes and show our clients and the companies how these issues align with the SDG agenda, and how they can make a positive impact."

BMO has also performed a mapping exercise, to show how engagement can fit into the SDG framework. "What is exciting with the SDGs is that each goal is associated with a list of very defined targets. Reading the appendix and digging down into the individual targets help understand how the goals can be attained. The framework mentions specific milestones to be achieved within a given period. As I am an analyst, these details make my job a lot easier. Many investors may have looked at the boxes simply to relate some of their investments to one of the 17 goals. For instance a company may have exposure to sub-Saharan African telecommunications, so it ticks the "access to communications" box. However, the way the SDGs are structured and how the underlying targets are set up, the question isn't so much where a company operates or derives its sales from as it is how the business operates. Responsible consumption, peace and injustice, bribery or gender equality imply a broad scope, which we believe is closely aligned with the work we do. The framework provides a great communication tool, that allows us to frame the work that we have been doing for a long time."

David Sneyd answers a question about how he links the SDGs to each engagement case. "We can use the SDGs when we look at specific engagement objectives," Sneyd explains. "I can take gender equality as an example. Here in the Nordic and elsewhere in Europe, the number of women directors has improved, but below the board, there is still an awful lot of work to do. One of the companies we hold, for example, is a large semiconductor manufacturer. The work the company performs generally demands a light level of technical skills, and they employ people with high-level university degrees. They only count 16% female in their workforce, while at the board, 30% of directors are women. We look at this discrepancy, and it has implications for this company's valuation. As investors, we look closely at their intangible value, which is generated by their R&D program. When we find out that there are only 16% of women, we worry that the program might not be functional. How do we know groupthink isn't an issue? We engage with the company at this stage, as we want to be reassured and understand how they are looking to tackle this problem. They may need to pro-

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Angelica Lips da Cruz, ALDC Partnership

mote job openings in universities or to fix their hiring process. We want them to understand what, in their culture, makes it so difficult for women to work there, or if there is a systemic issue that the entire industry should address."

"What motivates us," Sneyd continues, "is to address the specific risk we foresee. At the same time, the remedy to the issue is aligned with the SDGs. It is about reducing the gender gap, as well as extending quality education and work opportunities to a wider range of the population. In this example, the link to the SDGs is quite clear."

"In some other cases, it may be less obvious. My speciality is cybersecurity, and that is where I spend most of my time researching engagement opportunities. To look at Cybersecurity through the lens of the SDGs, we can take goal 11 which explicitly talks about building resilient infrastructure. At the same time, technology, in general, can be seen as an enabler for most of the goals, as it supports sustainable development."

"All of the goals need some technological solution, that is stable, safe, and able to withstand attacks. It is trickier to define exactly how cybersecurity contributes to each of the goals. Similarly, when we work to improve the resilience of a company that we are engaging with, it may be hard to draw a direct link to each goal."

"I do fear 'SDG washing', as many may use them in a context where they may not fit."

Anita Lindberg, Swesif

"Remember that the SDGs were not designed as an investment tool. We are all 'SDG washing', in a way. Admittedly, they represent a much better framework than what we have seen in the past, but it is still not perfect. We are working with something that needs interpretation."

Kaasinen agrees and asks the room for feedback and experiences on the use of sustainable development goals. "What do you think about SDGs?" she asks. "It has been three years since the framework was created. The first two years, there wasn't much happening, either on the investors' or on the companies' side. Now different actors are figuring out what it means for them and how they are prioritising it. How do you tackle the integration of the goals? What problems are you facing?"

For Anita Lindberg, the SDGs are far more useful a framework than the preceding ones. "We were looking for a framework for what we were doing, whether we looked at international conventions or the global compact or other norms. The SDGs are more tangible and better defined. The goals are indeed interlinked, which makes the framework very complicated. We should not cherry-pick the goals we like most, even if that is precisely what many of us do. All considered, the SDGs represent a very positive contribution to sustainability in the investment industry. It is a road map for where we are heading. I do fear 'SDG washing', as many may use them in a context where they may not fit."

"We have found a common language which is particularly useful, for investors like us who work in different markets and different countries."

Jennie Ahrén, Tundra Fonder

Angelica Lips da Cruz adds to Lindberg's point: "The SDGs have become a common language among many corporations, and some of them have understood that there are some important challenges that everyone needs to address, while some others are merely noticing, and still wondering if they need to act. When it comes to the underlying data, it is crucial to understand that they are not just goals, because goals are not measurable. It is challenging to find metrics to support the framework. We need to understand what the indicators are and how the KPIs should be designed to drive those goals. What is it you need, in the engagement process, to drive companies to change measurably? As we work with finetuning those metrics, we find that the SDGs have become a common language with targets and indicators behind it, which companies and investors both understand."

To illustrate SDG washing another participant points out that many map the SDGs by looking at revenue streams instead of looking at impact. "If I'm selling diapers, do I have a positive impact? Is it health? We need to be more sophisticated in our way of measuring the SDGs, which represents an enormous challenge. Being successful at evaluating the contribution of each investment to the goals moves us closer to impact investing."

Tundra Fonders' Jenny Ahren, has plenty of experience to share on the SDGs. "The goals are excellent in terms of communication, when approaching companies, not just for measurements. It is a work in progress though. We have been putting the goals in models, in the Maslow pyramid, because we had to establish a hierarchy of needs to start with. It is also a tool for collaboration, and we are working with a few goals at the time to get going."

"Recently, I attended an SDG breakfast, and I will be attending an SDG dinner in Karachi shortly, which will combine people working with the Global Compact in Pakistan with ideas from Sweden. This is an excellent tool in such a context. It is not perfect all the way down, and the indicators cannot all be measured, but we have found a common language which is particularly useful, for investors like us who work in different markets and different countries."

Not just ticking the box

"We believe that engagement should add value to the investment process," Sneyd says. "It shouldn't be a set up to tick the box. In general, we look to act as a trusted partner rather than take a confrontational, activist style approach, as we believe this is the most effective way to achieve our goals and to keep the dialogue open and constructive. We want to build trust with companies and aim for a long-term partnership. The most effective way of achieving what we want is to work with the company with a common goal, which is the long-term success of the company. We might have slightly different ideas on the ways to get there, and that is almost always where engagement focuses."

"For engagement to be effective, we need a deep understanding of the ESG issues that impact the business strategy. The subject of our engagement has to be relevant. If the company doesn't agree that we bring up a matter relevant to them, we have to build a good case to demonstrate the relevance so that they can take us seriously."

Corporate access

"Access is crucial," Sneyd insists. "We may have an advantage as an asset manager; the responsible investment team is not the only relationship-creating body within the organisation. Our fund managers have very active relationships with the companies in which they invest, and that is something that we can also leverage. We can always have access to Investor Relations, who are the most available, but they may only be able to provide more general information. When the answer is simply yes or no, we may obtain it through that channel, but sometimes there are cases where we may want to know if an issue is taken seriously at a strategic level, in which case we may want to reach out to a board director. It is only at this level that we can gain confidence that the company really is giving the issue some weight. The same is true of operational specialists, who will be able to answer detailed questions specific to their area of activity."

For Sneyd, diplomacy is key to carrying a message across. "As we hold stocks in companies," he states, "we have the opportunity to hold regular dialogue with management, whether it is during their quarterly earnings call or another occasion. We try to balance the way we deliver compliments and criticisms. One of the areas we often talk about is reporting, as we need metrics and they are usually in short supply. I have had several conversations where I have asked a company to increase its impact reporting. Many companies push back: 'Why should I do that?' They don't necessarily appreciate many investors care about this information nowadays. To motivate them, we may argue that one of the core reasons we hold the position in our portfolio is because of the values they exhibit in specific areas. Engagement is useful because it provides a feedback loop. Fund managers often tell companies what they like about them and why they are invested."

"Expanding the conversation can help improve the quality of the relationship between investors and companies, but I do feel sorry for investor relations teams sometimes. Answering requests from a widely dispersed array of investors can represent significant work for them. Meanwhile, they may not understand what investors make of this information. We need to make sure they understand why this is important to us. An increasingly large part of the capital markets find this information relevant."

"Most of the time, the companies are not surprised by the questions we ask. When we talk to a utility company on climate change, that is a part of their day-to-day concern, particularly for some functions in the business. We may try to help the company raise certain points up the agenda, instead of bringing up an entirely new set of issues. As investors, we voice our concern and highlight the work that one department somewhere down the hierarchy is working on. Directors and top management are often pressured to chase short-term profitability. They may worry about taking on a cost or invest in solving long-term ESG-related issues. By gaining the company's trust and working together as investors, we can help them take such decisions confidently."

Escalation & votes

"Unfortunately, engagement doesn't always work. Escalation is, therefore, an important tool for us as well. On the one hand, we do collaborate with other investors, and we are a member of several collaborative organisations. By aggregating our internal holdings with those of the clients we engage on behalf of, as well as those of other like-minded institutions, we can convince a company that the matter at hand is worth the effort. We may co-sign a letter or co-host a meeting. We are trying to show the company that we are not alone caring about this issue. The larger the group, the larger the attention we can gather."

"Ultimately we can also use our vote. Directors may not admit it, but we know that they do look at the numbers on their election. If we feel that the board has failed in some respects, or if management lacked competence in oversight of a particular issue, voting can be a way to register that disagreement, adding to the pressure we have already built up by engagement dialogue."

Defining a change objective

To optimise engagement efforts, Kaasinen explains, having a specific change objective is crucial at the onset. "Engagement does not merely consist in chatting with companies, or sending questions, but it should inscribe itself in a clear agenda. Identifying the target problems and what an investor hopes to achieve are central to the process from the start. Without clearly defined goals is it hard to determine when to stop and to measure in hindsight what impact has been achieved."

In the context of Sustainalytics' work, which is also relevant in the case of reactive engagement, the stated purpose of engagement should be to go beyond fixing a specific incident. "It is about proactively making sure that the company strengthens its policies and practices to ensure a similar occurrence will not happen in the near future. Even reactive engagement has a proactive element to it," says Kaasinen.

Client involvement

Client involvement is another critical element of successful engagement, whether reactive or proactive. "Individual investors often don't have the resources, the time or the expertise to engage with companies on their own," explains Kaasinen. "Others don't feel that they have sufficient leverage, approaching the company alone. Getting together with other investors either directly or through service providers like Sustainalytics and BMO can help pull resources together and be more efficient, making sure that interests are aligned with others. Collaboration helps bring convergence between investor positions, makes full use of key authority expertise and aligns the message that reaches the company. It is vital to be heard and be responsive while hearing what others are saying and keeping an ear on the ground to minimise any harm contradicting signals may generate for companies."

“Have you ever tried to approach companies to teach them something?”

Anita Lindberg, Swesif

Free consultancy for companies?

The idea that an engagement service feels like ‘free consulting’ to the companies, sometimes, resonates with Swesif Chairwoman Anita Lindberg. She argues that some managers may go further in that dimension. “I met an asset manager last week,” she says, “who talked about a project where they set up an educational strategy. They were not directing engagement to a specific theme. Instead, they defined some topics they wanted to teach the companies. Have you ever tried to approach companies to teach them something?”

“In terms of the free consultancy,” Kaasinen says, “there is a line that we try not to cross. We talk to the company to establish how they look at certain issues and make sure they understand why we are concerned. We discuss the potential gaps we observe and suggestions to remediate them. It is, however, a different thing to hold their hand and walk with them. We share ideas, keeping an open dialogue, and expect them to be able to tell us how they will bridge those gaps and, eventually, show the changes they have implemented.”

Sneyd adds: “Sometimes companies approach us with a blank canvas, such as an empty materiality matrix for instance. They ask us where the risks fit in a given framework. We are not able to do the work for them, however. Companies know their business better than we do. We remain outsiders. The company has to perform the initial work in-house. Those are blatant cases, where companies believe they can obtain free consultancy. We have to reverse the table, let them come up with something we can then comment on. It is quite worrying when a company admits they can't fill in the required information and ask us to do it for them.”

Engagement avenues

Kaasinen indicates different avenues for engagement but gives a few words of caution. “There are a number of platforms offering opportunities for collaborative engagement. For example, in Sweden, as an investor, if you have a sizeable holding in a company, it is likely that you will come across other investors that are worth reaching out to. Three investors are still better than one, even if you cannot stick together about all the issues. Joining forces is mostly an advantage, except when investors have diverging focus points, and perhaps when investors have to share information that they may have preferred to keep to themselves.”

“There is also the risk of meeting a free rider. If you share everything with others, you may end up doing all the work, and the others sit there and get the benefit. When associating with others, I would recommend clarifying expectations from the beginning and determining who will commit to what part of the work. You may need to take a larger part of the burden if you want to gather the force of others who are less interested in the cause than you are.”

Sneyd adds a few words of warning: “Recently, we approached another investor to join forces, as we had difficulties engaging with one of our large holdings. We set out our objectives, and the other investor started cherry picking which items they agreed with and which ones they didn't. In the end, we mutually agreed that collaboration was not going to work because we would have had to dilute our message and our expectations from the company too much relative to our goal.”

“The PRI proposes valid alternatives for investor cooperation. They have a section on their site, where you can see open letters that you can co-sign, which is a quick and easy way of jumping on someone else's bandwagon. We are also members of a variety of engagement groups. I am personally involved in the governance of a cybersecurity group. Whenever we engage with a company, we report back to all our investors. It can be helpful to be part of a group, especially when you are not an engagement expert. Participating in a group means that everyone will share in the conversation. However, having an open discussion doesn't necessarily mean that we are working in concert, in a way that could be construed, in some markets, as collusion. Talking about sustainable goals is not price sensitive, and we can collaborate on those matters without crossing the lines.”

“Collaboration comes with its costs as well as benefits, of course,” Sneyd continues. Recently, we have observed a strong trend with larger, generally passive managers in terms of engagement, joining investors who have been engaging for much longer, and supporting them with their holdings. Having larger pools of shares can help a cause. Shareholder proposals are also an effective tool. Large asset management houses used to be sceptical to those proposals and supported them rarely. Slowly, they have started paying more attention, as the proposals are better thought through. This is a form of collaborative engagement.”

Meeting different investors' expectations

"How do you expect the standards to evolve? Investors' diverging expectations surely make it more difficult to engage in concert."

Claudia Stanghellini, AP3

AP3's head of external management, Claudia Stanghellini, asks both Sustainalytics and BMO to share their expectations for the standardisation of sustainability-related definitions: "ESG means different things to different investors. Each investor has its definition and needs. As a result, asset managers get many different requests. How do you expect the standards to evolve? Investors' diverging expectations surely make it more difficult to engage in concert."

For Kaasinen, relying on international standards and international norms helps. "These should be the foundation of both investors' expectations and companies' operations," she says. "Most countries or organisations sign UN-related treaties. The ILO's labour standards or the Global Compact are some of the most common ones. Beyond the norms themselves, there are nuances in the interpretations of course, and these may differ. I don't think it is possible to apply the same standards to every company in every situation. Adapting the engagement process and tailoring the dialogue to the issue at hand and the company is key. Merely copying the process of previous experience may not cut it."

A service provider like Sustainalytics must adapt to a multitude of agendas when working on behalf of several clients in the same case. "Coming back to our Walmart example," Kaasinen explains, "we are leading the dialogue for many investors, some may want to push Walmart on labour-related issues, whereas others may opt to go around those questions, to obtain results on less controversial matters. When we organise a call with a company, for instance, we remain mindful, as a service provider, not to step on anyone's toes. We work to understand the facts and also give investors the opportunity to ask their questions. We have a standard agenda, which tries to address all the points, but we also make sure that those who participate on the calls have a chance to ask something that they want to push personally. Sustainalytics may not push this particular point, because we are speaking for all our clients, but we are happy for individual clients to bring up their questions. We focus on the issue we have identified, which is relevant for all our clients."

At BMO, Sneyd works on engaging on behalf of different internal investors. "As a group, we do have autonomy to pursue our agenda, but we prefer to engage alongside the fund manager or the individual who is responsible internally for a particular holding. We can leverage our activity more powerfully when we work together. It is very rare that we find opposition for our engagement efforts, but we may, sometimes, encounter some indifference. We are fortunate to have CIO buy-in, which means that, if we ever need to, we can push our agenda through."

Evolving reporting standards

David Sneyd explains how the team reports to clients and to stakeholders. "In the same way as we are honest about where we fail, we do like to log where we achieve results through the use of 'milestones'. We assign one to three stars given the importance or magnitude of the change we believe we have achieved for investors. Three stars are reserved for situations when our process has been a real game-changer, where our action has created a turn in the company's history. One star corresponds to an incremental change, which can be just as valuable, because companies may change slowly over time, and we like to track that as well. We also adapt our star rating, to take into account the expectations in a given market. For example, recently, the CEO of an Indian bank stepped aside, following our request for him to do so, while he underwent investigations into allegations against him. In India, this kind of reaction is a real achievement, and we rated that case with three stars. The scale of receptiveness is so different there than in Europe, for example."

The team aggregates the milestones by region and by theme and produces individual reports for our stakeholders. "We have a degree of responsibility to report publicly, particularly with our stewardship responsibilities. We provide annual reports, but we also report to clients ad hoc and quarterly. We give an overview and show how we evaluate what has happened, irrespective of the progress achieved.

Should unifying reporting standards be a priority?

Sneyd adds: "I know that the Sustainability Accounting Standards Board (SASB) is working hard to standardise measurements. They are pushing for their standards to be used more globally to increase the level of disclosure. Ultimately, we want companies to disclose issues that are material to them, and that differs from company to company. There may be a trade-off between requiring too much data that isn't relevant, for the sake of standardisation, which may represent too high a hurdle for companies, and settling for the lowest common denominator, which everyone agrees on. Like-for-like comparisons are tough in many areas. Traditional accounting standards are not uniform across the world either, and understanding the differences is part of any investment analysis. Companies are given a wide degree of discretion over revenue recognition, depreciation, or other measures of financial performance. Ideally, we should reach a level of standards with a basic level of expectation, combined with the flexibility to adapt to a company's unique circumstances. From there, most importantly, we should be able to interpret those standards and obtain a like-for-like comparison with a small degree of tweaking. We are still far from that bar. Some organisations are working on it but not without difficulty. There is a cultural take on different initiatives. The Global Reporting Initiative (GRI) is very popular in one part of the world, but not everywhere. When looking at 8,000 companies across borders, like we do, the task remains challenging."

Kaasinen provides another example related to water, one of Sustainalytics' major thematic engagements themes. "We have observed a proliferation of different standards and questionnaires related to water. In our engagement process, we recommend the CDP water reporting to companies, but we are not overly prescriptive. We don't mind if they disclose similar facts in some other manner, if they can justify why that works for them. All we care about is the disclosure of the data. How we get it, is less important. Ideally, it should be comparable. With water,

"We have observed a proliferation of different standards and questionnaires related to water."

Tytti Kaasinen, Sustainalytics

in particular, we looked at different types of disclosure on the companies' reports, and they were hardly comparable. In those cases, we may still be able to watch the company's progression over the years, which is useful."

Angelica Lips da Cruz comments on the human aspect of the business. "There are people behind operations, culture or investments. After working so many years in investment banking, I have come to see that transparency in disclosures and information, in general, come when incentives push people to cooperate. Finding a common language such as the SDGs, for example, makes data more tangible and incentivises people to work towards a common goal. We may be reaching a point where engagement has become substantial enough.








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