

THEMATIC RESEARCH

ENGAGEMENT:

UNLOCKING THE BLACK BOX OF VALUE CREATION

Niamh O'Sullivan & Jean-Pascal Gond / June 2016

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SUSTAINALYTICS

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Foreword

About the Sustainalytics-Cass Partnership

In March of this year, Sustainalytics formally launched its Academic Program to meet growing interest from the academic community with regard to environmental, social and governance (ESG) research. One of the Program's goals is to partner with leading academic institutions to publish innovative responsible investment research. In late March, Sustainalytics announced its partnership with Cass Business School London, a prestigious academic institution renowned for its finance and corporate social responsibility (CSR) research. Cass welcomes the opportunity not only to access international ESG data to help advance its research and teaching curricula, but also to co-develop cutting-edge responsible investment research that bridges the academic-practice divide.

Our research teams identified the engagement activities of the Responsible Investment industry to be a particularly attractive area for a first collaborative research project, in part due to the rise in the absolute and relative importance of engagement in terms of Assets under Management. In particular, our research focuses on *individual* dialogues about environmental and social issues between institutional investors and investee companies, as prior research has largely focused both on governance-related engagements and collaborative ESG engagements from groups of institutional investors. Through 36 in-depth interviews with institutional investor representatives across three important European engagement markets (France, the Netherlands and the UK), our joint project contributes to closing a significant research gap.

About this report: Opening the “black box” of engagement

In particular, our research report opens up the “black box” of engagement and reveals more nuanced insights into the daily structure, execution, management and impact of engagement processes, as well as the important interrelationship between engagement and ESG integration efforts. The results help to make sense of the complexity of engagement by presenting a new typology of the various styles of engagement conducted by institutional investors, as well as the multiple forms of value created by engagement practices beyond financial materiality. We believe that the analytical tools provided in this report will allow institutional investors to benchmark their engagement activities against those of their European peers and will inform policy-making on the diffusion and potential standardisation of engagement practices, while stimulating further empirical research on the impacts of engagement across European countries and beyond. We hope you enjoy reading our report.

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Engagement: Unlocking the black box of value creation

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Key Takeaways

- Our **36 interviews with institutional investor representatives in France, the Netherlands and the United Kingdom** have revealed a wide range of approaches to engagement on environmental and social issues, regarding engagement **(1) policies; (2) processes** (triggers; management & execution; monitoring, evaluation & recording); and **(3) outcomes**, impact and accountability practices.
- Our research evidences the ways in which **ESG engagement and ESG integration have become interrelated processes**, with increasing communication, cooperation and collaboration between ESG analysts and financial analysts on engagement.
- In the interview analysis process, we came to identify **four dominant types of engagers** (based on the degree of interaction between ESG integration and engagement maturity): **emergent** engagers; **compliant** engagers; **purposeful** engagers; and **progressive** engagers.
- Though there are increasing market demands for financial materiality, interviewees feel that **fiduciary duty and stewardship extend well beyond financial materiality**. Pressure from asset owners to prove the financial materiality of engagement is not pronounced across all three countries.
- Based on our interviewees' responses, we have categorized **seven values** associated with engagement beyond financial materiality: **financial** value; **stewardship** value; **knowledge** value; **collaborative** value; **relational** value; **signalling** value and **environmental and social** value.
- **Quantitative measurement** of engagement success remains elusive, particularly as changes in company behaviour are multi-factorial and difficult to tie to one engagement process.
- The notion of **environmental and social materiality** has been relatively **neglected**. The monitoring, evaluation and recording of the environmental and social impacts of engagement requires greater attention.
- While progress is being made, there is the **need for greater consistency in the scope, content and quality** of institutional investor (environmental and social) **engagement disclosures** across all countries.
- There is increasing interaction between asset owners and managers in engagement activities, yet far less attention is being paid to the **important influence beneficiaries** can have in shaping engagement processes.
- **ESG research providers play an essential role** in helping to trigger engagement activities, but greater involvement in monitoring and measuring engagement outcomes could provide further value.

Introduction

Engagement – Increasing its currency

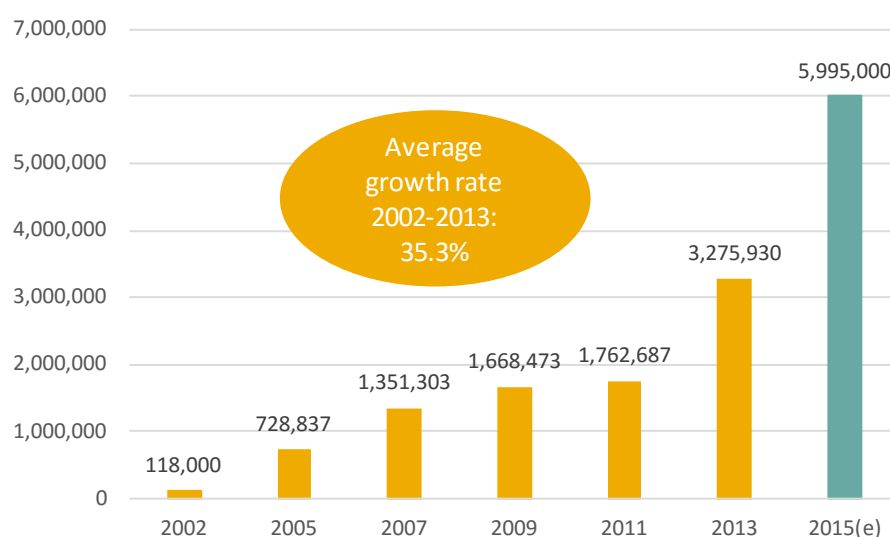
Continued strong growth in European engagement strategies

How are institutional investors effecting change in investee companies and creating value? For many years engagement has been considered a useful mechanism for institutional investors to advance their responsible investment strategies, manage the environmental, social and governance (ESG) risks associated with their investee companies, ensure long-term value creation, and contribute to more sustainable societies.¹ According to Eurosif, engagement and voting strategies grew by 35.3% per annum between 2002 and 2013 in Europe, resulting in €3.3 trillion assets under management (AUM) subject to engagement by the end of that period.² More recent numbers are not yet available at the European level, but individual country data speak in favour of a continuation of this trend. For example, in the so-called DACH region (Germany, Austria, Switzerland) 2015 numbers have already been reported, showing a jump in AUM subject to voting and engagement to €157.3 billion from €45.5 in 2013 (+246%).³ This makes us confident that our estimate of €6 trillion AUM subject to engagement in Europe in 2015 may be a rather conservative one.

Today, the market provides regular newsfeeds about institutional investors either entering into direct dialogue with companies about their ESG performance and disclosure, or the outcomes of such ESG dialogues between them. Academic studies have emerged to prove the financial value of engagement,⁴ and no responsible investment conference appears complete without some discussion about the materiality of engagement.

Growth of engagement and voting in Europe (in million Euro)

We estimate that the European engagement and voting market has reached a volume of €6 trillion in 2015



Source: Eurosif (2014), own estimate⁵

More consistent transparency needed

Surprisingly little is known about engagement processes

However, despite the recognised importance of engagement, surprisingly little is known about the actual daily management, execution and impacts of these engagement processes, especially those related to individual, as opposed to collaborative, institutional investor-company dialogues, and particularly those associated with environmental and social, as opposed to governance, issues.

Some provision has been made to increase institutional investor transparency and disclosure about the nature, approach and outcomes of their engagements, through: the “Listed Equity Active Ownership” section of the Principles for Investment (PRI) Reporting Framework;⁶ related reporting requirements of European stewardship codes, such as the Financial Reporting Council’s (FRC) Stewardship Code in UK,⁷ and the Eumedion’s Best Practices for Engaged Share-Ownership in Netherlands;⁸ or, for example, the UK’s National Association of Pension Funds (NAPF) (now known as the Pensions and Lifetime Savings Association) Stewardship Disclosure Framework,⁹ as well as transparency requirements from a new French law on the energy transition.¹⁰

Revision of reporting standards required?

However, some of the most relevant PRI active ownership reporting indicators remain voluntary,¹¹ stewardship codes adopt a comply or explain approach, and access to individual institutional investor reports, against these codes, especially in the case of Eumedion in the Netherlands, can sometimes be limited. Beyond this, there are currently no international or European standardised guidelines for institutional investor public disclosures of their engagement policies, approach and impact. Meaning the content and quality of such disclosures remains highly varied across European institutional investors, and engagement activities as a whole have become something of a black box.

ShareAction survey shows a wide variation in the quantity and quality of UK institutional investors’ stewardship reporting

For example, empirical evidence about institutional investor transparency on engagements with corporates is very limited. In a relatively recent study undertaken by ShareAction, 33 occupational pension funds, insurance companies and asset managers in the UK were evaluated regarding their “Responsible Investment performance and transparency”, with 24 responding to a survey.¹² The study showed that while “best practice is evolving rapidly” as evidenced by the engagement disclosures provided by industry leaders, there has been “no meaningful improvement amongst the laggards” over a considerable period of time.

In light of the dearth of engagement reporting, as well as the pending implementation of the recently revised EU Shareholder Rights Directive (Directive 2007/36/EC),¹³ which requires enhanced transparency across the investment chain, including improved quality and mandatory disclosure of institutional investors’ (ESG) engagement with investee companies, we felt it an opportune time to explore the black box that is engagement.

We address some of the ambiguity surrounding engagement and its value creation

Our approach – Exploring engagement in more depth through 36 institutional investor interviews

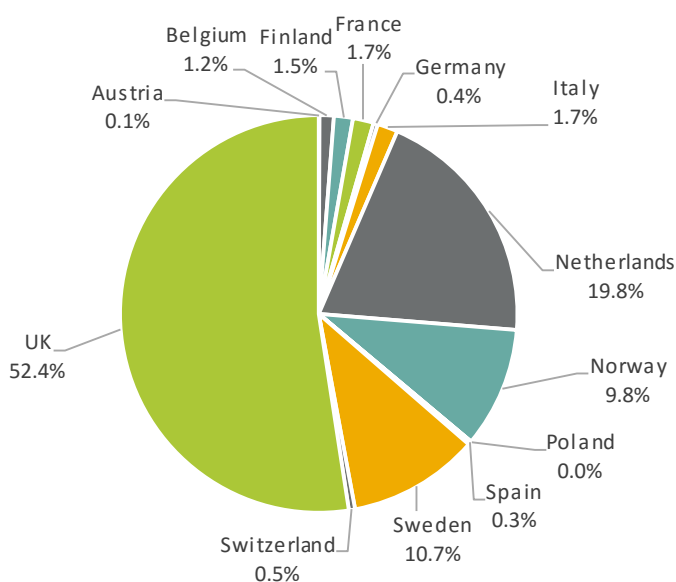
Unlocking the black box of engagement

This report seeks to address some of the ambiguity surrounding engagement processes and, quite importantly, the (notion of) value associated with them. The aim is to present in-depth insights into engagement practices, as captured through the eyes of the practitioners themselves, in order to better understand the challenges and benefits associated with engagement.

Our focus is on individual environmental and social dialogues between institutional investors and investee companies, both internal and outsourced, as opposed to collaborative engagements. We also do not focus upon ESG voting strategies and activities. We have chosen to concentrate on the UK, Netherlands and France only, as both the UK and Netherlands are currently the two leading European markets for ESG engagement (see table below), while France is a good example of a market where engagement has recently begun to grow in importance, which offers interesting opportunities for comparison and contrast in our analysis of European engagement practices as a whole.

In order to gain a deeper understanding of engagement activities, we have adopted a qualitative approach to our research and analysis, conducting 36 semi-structured interviews with institutional investor representatives.¹⁴ Our institutional investor interviewees include a range of asset owners (9); asset managers (25); engagement service providers & asset managers (2),¹⁵ with collective AUM of over EUR 6.4 trillion (both actively and passively managed), and representing some of the most prominent ESG engagers in the market. (Please see the Appendix for a more detailed overview of our research methodology and list of participating organisations.)

Engagement and voting in Europe – Market share by country



Source: Eurosif (2014)¹⁶

Benchmarking engagement activities – Executive summary of results

From an institutional investor perspective our report offers an opportunity for investors to benchmark themselves against the ESG integration and engagement practices of their European peers, and allows them to gain a better sense of the different types of value their practices are creating in comparison to other engagement approaches.

Typology of engagement and engagers

Based on our interview analysis, we have produced a unique typology of engagement and engagers, as well as the forms of value that each can create. We identified two central issues that differentiate interviewee approaches to engagement. These are: **(1) the level of ESG integration** at the organisation; and **(2) the maturity of the engagement processes**, i.e. how structured and formalised these processes are (see also “Glossary of Terms” in the Appendix). By investigating these two issues, we identified four different types of approaches to engagement and thus engagers, which we term: **emergent**; **compliant**; **purposeful**; and **progressive**. The resulting typology of engagement and engagers is presented below.

Typology of engagement & engagers

Engagement Maturity

		Low	High
ESG Integration	Low	Emergent Engagers	Compliant Engagers
	High	Purposeful Engagers	Progressive Engagers

Source: Sustainalytics & Cass Business School

The main focus in the above typology is on how ESG integration is impacting engagement processes (e.g. how ESG screening and/or fundamental & thematic analysis prompts engagement), and in turn, how the level of maturity of engagement processes is impacting ESG integration efforts.

As will be outlined in more detail later, each engager type is determined based on interrelated, yet variant, levels of ESG integration and engagement activities we observed in our interview data. This relates in particular to the interrelationship between ESG integration and key dimensions of engagement, such as **(1) policies**; **(2) processes** (triggers; management & execution; monitoring, evaluation & recording); and **(3) outcomes**, impact and accountability practices.

Benchmarking European engagement activities

Interrelationship between ESG integration and engagement

We identify four types of engagers

More precisely, we have identified four types of engagers as follows:

- **Emergent Engagers** are institutional investors with low levels of ESG integration (such as screening, fundamental analysis, thematic analysis), and whose engagement processes are in the early stages of maturity (less structured/formalised), as they are new to or exploring the responsible investment space. In turn, their less mature approach to engagement can lead to less ESG integration (feedback) potential from engagement activities.
- **Compliant Engagers** are institutional investors with low levels of ESG integration, but who may have a more mature approach to engagement, due to, for example, regulatory/stewardship code and/or client requirements. However, their more mature approach to engagement does not necessarily lead to more ESG integration (feedback) potential from engagement activities, as their primary focus is on doing engagement to meet externally imposed requirements.

Purposeful engagers have high levels of ESG integration, but a less mature approach to engagement

- **Purposeful Engagers** are institutional investors with high levels of ESG integration but a less mature approach to engagement. Here we identified two subgroups:
 - (1) **Culturally driven:** Sustainable/ethical-based banks or insurance firms whose screening processes exclude many stocks that could require engagement, or mainstream investors where ESG is a core part of their “DNA”, and they do not formally structure their engagement processes;
 - (2) **Strategically driven:** Mainstream investors who have undertaken engagement specifically to inform their ESG integration (such as best-in-class screening) efforts and do not formalise their engagement processes.

In turn, a less mature approach to engagement, in both the culturally or strategically driven case, may not hamper but may act to enhance ESG integration (feedback) potential from engagement activities.

Progressive engagers have high levels of ESG integration interrelated with mature engagement processes

- **Progressive Engagers** are institutional investors with high levels of ESG integration, assisted by sophisticated proprietary tools, as well as a mature approach to engagement through, for example, the setting of specific engagement milestones and objectives that are tracked, monitored and recorded to determine engagement “success”. In turn, their mature (structured/formal) approach to engagement leads to more ESG integration (feedback) potential from their engagement activities due to their advanced technological tools (databases) and operational/relational systems (between ESG & fund managers).

We would like to stress, however, that we view all of these engager “types” as being positioned on a continuum between low and high levels of ESG integration and low and high levels of mature (structured/formalised) approaches to engagement, so that there can be a movement from one type to the other over time. We have represented this through the dashed line between each type in the above (2x2) typology. Some institutional investors may therefore find themselves straddling two (or more) types.

Seven types of value creation

We unpack the notion of value associated with engagement

In turn, our typology helps us to identify and classify seven different types of value, associated with each of the emergent, compliant, purposeful and progressive types of engagement. Our interview evidence therefore allows us to “unpack” the notion of value associated with engagement, to reveal the range of value created by engagement activities beyond financial returns per se. These categories, which are discussed in more detail at the end of our Findings section, include the following:

We categorise different types of value created through engagement

- **Stewardship Value** relates to the importance of engagement for institutional investors to fulfil their stewardship and fiduciary duties for their clients and beneficiaries, which can also enhance their broader social accountability and legitimacy.
- **Knowledge and Collaborative Values** relate to the increased internal ESG knowledge and expertise that engagement creates for investment decision-making, the closer collaboration and comradery between ESG and financial analysts that engagement facilitates, and hence the overall advancement of ESG integration within institutional investors.
- **Signalling and Relational Values** relate to the important role engagement plays in alerting companies to the ESG preferences and requirements of institutional investors, as well as the development of long-term, trusting relationships with them.
- **Environmental and Social Value** relates to the potential direct and indirect benefits to the environment and society that can transpire from engagement activities.

In the table below, we outline which category of value we believe our engager types are most likely to facilitate through their integrated engagement efforts.

Value created through different types of engagers

Values created through engagement	Emergent Engagers	Compliant Engagers	Purposeful Engagers		Progressive Engagers
			Culturally driven	Strategically driven	
Financial Value	LOW	MEDIUM	MEDIUM-HIGH	MEDIUM-HIGH	HIGH
Stewardship Value	LOW	HIGH	MEDIUM-HIGH	MEDIUM-LOW	HIGH
Knowledge Value	LOW	LOW-MEDIUM	MEDIUM-HIGH	HIGH	HIGH
Collaborative Value	LOW	LOW-MEDIUM	MEDIUM-HIGH	MEDIUM-LOW	HIGH
Signalling Value	LOW-MEDIUM	HIGH	HIGH	HIGH	HIGH
Relational Value	LOW	LOW	MEDIUM-LOW	MEDIUM-HIGH	HIGH
Environmental and Social Value	LOW	MEDIUM	HIGH	MEDIUM-LOW	MEDIUM-HIGH

Source: Sustainalytics & Cass Business School

Progressive engagers are most likely to create the highest value

As displayed above on page 11, we believe that emergent engagers are the most challenged when it comes to creating a substantial amount of value across all seven of our value categories, while progressive engagers are most likely to create the highest value. However, we believe our purposeful/culturally driven engagers are best positioned to create environmental and social Value. Additionally, we believe that compliant engagers have the capacity to create high levels of stewardship and signalling Value, but lower levels of knowledge and collaborative value, due to their emphasis on engagement over ESG integration. Finally, we consider our purposeful engagers collectively to be able to create high levels of signalling value, and relatively high levels of financial value. To break this down further, we perceive that culturally driven investors may create higher levels of stewardship value and environmental and social value, due in particular to the “Principles with Profit” ethos of sustainable/ethical institutional investors; and strategically driven investors may create slightly higher levels of knowledge, collaborative and relational values, due to their focus on engagement as a means of assisting ESG integration.

These categories of value will be discussed in more detail at the end of our Findings section. This categorisation can assist institutional investors to identify, monitor and disclose the range of value created by their engagement efforts in a more holistic manner than is currently practiced.

Report structure

Findings section will be structured around the discussion of the different approaches to engagement

Following a brief overview of market-related engagement trends, as well as our interviewee organisations, our Findings section will be structured around the discussion of the different interviewee approaches to engagement: policy; process (triggers, management & execution, monitoring, evaluation & recording); outcome, impact and accountability practices, which act as the key components of our typology. The report ends by showcasing our complete typology of engagers and their value creation and offers some suggestions for institutional investors, standard setters and ESG research providers to take into consideration regarding the future of engagement.

Setting the scene

The context behind engagements

The UK and Dutch engagement markets are the most advanced in Europe

Prior to our in-depth discussion of engagement processes, we would like to briefly consider the cultural context, key industry trends, as well as organisational context of our interviewee organisations, which set the scene for our research participants' approach to their environmental and social engagements.

Three engagement markets

The UK and Dutch engagement markets are the most well established in Europe. This is reflective of the growing ESG expertise and sophistication of institutional investors in these markets; a traditionally strong civil society associated with responsible investment campaigns in both countries; as well as the introduction of the Stewardship Code in 2010 in the UK, and the Eumedion corporate governance and sustainability framework in the Netherlands since 2006. The French engagement market is somewhat less mature, largely due to the absence of extensive shareholder activism, as well as the dominance of best-in-class screening practices as the main form of responsible investing. However, recent regulatory drives (e.g. article 173-VI of Law 2015-992 on the energy transition mentioned earlier),¹⁷ and increased activity of large asset owners in this space, suggests that there will be an intensification of engagement efforts amongst French institutional investors in the coming years.

Focus and catalyst of engagements

Still more focus on governance than environmental and social issues in engagement

Engagement on governance issues still remains the most advanced throughout each market, reflective not only of the long-standing tradition of governance-related active ownership in the UK and Netherlands in particular, but also the prescriptions of current stewardship codes. For instance, in the most recent Investment Association survey of UK institutional investor adherence to the UK Stewardship Code, remuneration was listed as the **most frequently** engaged-upon topic from the 130 respondents (out of 280 Stewardship Code signatories), while corporate performance was voted as the **most important** issue to engage upon out of a list of 12 possible issues. Environmental and social issues were listed as the 7th most important to engage upon, out of the total list of 12 issues (see table below).

Despite these trends, we did not necessarily get the impression from our interviewees that environmental and social issues were deemed any less important than governance issues for engagement per se, but rather that each was awarded attention on a case-specific basis. However, we did find that the majority of interviewee organisations' experience engaging on governance issues had acted as the primary catalyst for their environmental and social engagement efforts. Yet, many interviewees also stressed additional senior-level foresight and buy-in; increasing client interest and demand; corporate scandals; as well as market developments as other key catalysts.

Environmental and social issues ranked 7th out of a possible 12 important issues to engage upon by UK institutional investors

Issues voted as most important to engage upon in the UK

Issue	2014	2013	Change
Corporate Performance	1	-	
Leadership - Chairman/CEO	2	2	
Culture and strategy	3	1	⬇️
Board and committee composition/succession	4	3	⬇️
Remuneration	5	4	⬇️
Capital structure, including equity issuance	6	9	⬆️
Environmental/social issues	7	8	⬆️
Risk management/appetite	8	7	⬇️
Merger and acquisitions	9	5	⬇️
Corporate actions and restructuring	10	6	⬇️
Reporting, audit and audit tendering	11	10	⬇️
Health and safety	12	-	
Sample size	69	72	

Source: Investment Management Association¹⁸

Interviewee context

Wide range of interviewees

Our research sample encompasses a number of different types of institutional investors, some of the most distinct including: sustainable asset managers (2); a sustainable insurance firm (1); mainstream insurance firms (2); a faith-based asset manager (1); a mainstream asset manager with a partnership structure and no shareholders (1); and passive asset managers (2) (see the Methodology section in the Appendix for more details on all interviewees). We found the organisational context and culture of interviewee organisations to play a key role in their motivation for and/or approach to engagement, thereby influencing our typology of engagers discussed later in the report. The size of interviewee organisations also varies greatly between the largest asset managers with: €987 billion (French); €945 billion (UK); and €417 billion (Dutch) AUM; to the smallest representing: €3.5 billion (French); €3 billion (UK); and €1.9 billion (Dutch) AUM.

Size does not necessarily affect the level of commitment to or relative “success” of engagement

While we found that the size of the organisation certainly influenced the resources allocated to engagement activities and hence how mature (structured or formalised) those processes may be, we did not necessarily find that this affected the level of commitment to or relative “success” of engagement. Relatedly, there is a wide range of organisational experience with environmental and social engagement amongst interviewee organisations, ranging from approx. 10–12 years for some of the larger asset managers, to just 1–3 years in some of the smaller institutional investors and/or some of the participating French institutional investors. This allowed us to gain an understanding of the engagement landscape across our three countries, which greatly informed our analysis of the differences in engagement processes as well as our typology of engagers. Finally, our interviewee organisation engagements are not confined to either an active or passive management approach, or any asset class. However, the predominant form of engagement activity across all interviewees is focused on equities under active management.¹⁹

Findings

Exploring engagement in depth

Introducing the component parts of our typology

With the cultural, industry and organisational context of our interviewees in mind, our Findings section will now discuss interviewee practices surrounding engagement with regard to **(1)** policies; **(2)** processes (triggers, execution & management, monitoring, evaluation & recording); and **(3)** outcome, impact and accountability. The analysis of different interviewee approaches to these engagement practices allowed us to develop the component parts of our typology of engagers, as will be highlighted at the end of each key section of the Findings, and presented in full on page 41 of this report.

Engagement policies & definitions

Only a small number of our 36 interviewee organisations have a publicly available engagement policy

As noted in the most recent Eurosif SRI survey, approx. 42% of respondents to the survey had a formal engagement and voting policy, with approximately 24% of them making this public.²⁰ We witness similar trends across our 36 interviewee organisations, with only a small number of them having a publicly available, engagement policy; that is, one that is separate from an overarching responsible investment (RI) policy. Some French organisations have only recently adopted an

"I think the partners and some of the firm managers were already doing it without knowing it was called 'engagement'."

(French asset manager)

engagement policy (between 2013 and 2015), or are in the process of formalising their engagement policies or (web-based) statements. The majority of interviewees across the three countries, however, tend to include a section on engagement within their

RI policies, guidelines and/or stewardship policies. In general, we found a wide disparity across interviewee organisations regarding the content of their engagement policies/statements, especially regarding the level of detail in the explanation of engagement: strategy; definition; approach; management; monitoring and recording of outcomes; and integration with other RI strategies or general investment approach. Overall, it would appear that more experienced ESG engagers tend to have the most elaborate policies or statements in all three countries.

Lack of clarity surrounding the definition of engagement

An ongoing issue is the lack of clarity surrounding the definition of engagement itself, the notion of "activism" it connotes in the French market in particular, and the overall confusion this causes for institutional

"[We] define engagement as the activities undertaken in order to bring about change in the environmental, social and corporate governance (ESG) field through dialogue with companies and markets. We strive for a constructive dialogue with the companies in which we invest on behalf of our clients and with market participants, such as regulators, supervisors and sector organisations."

(Dutch asset manager interviewee, extract from RI Implementation Guidelines, 2014)

investors, policy makers, standard setters and broader investor stakeholders. Our

analysis shows that only a small number of interviewee organisations clearly define what engagement means for them publicly – that is, both in terms of an explanation of the term, as well as what actions they consider constituting an engagement, for example an email, a letter, telephone calls, face-to-face meetings/purposeful dialogues or a combination of all of these. Those definitions that are available predominantly centre on the notion of effecting change in investee company behaviour to ensure positive risk-adjusted returns for clients, and/or, outline that it is the institutional investors’ fiduciary duty to take material ESG issues into consideration to secure long-term value creation for their clients and beneficiaries.

Lack of attention to the broader environmental and social motivation and/or impact of engagement

Much less attention appears to be paid to the broader environmental and social motivation and/or impact of engagement in these policies, apart from that explicitly recognised in some passive asset manager or sustainable and faith-based institutional investor engagement policies. This appears to be because passive managers, especially those working for pension funds, have the incentive to consider the long-term trajectory of sustainability issues and their impact on client’s universal ownership requirements more than active managers applying short-term “buy” and “sell” strategies do. And, sustainable and faith-based institutional investors’ “Principles with Profit” ethos informs their primarily sustainability-oriented motivations for engagement.

Interviewees were themselves dissatisfied with the variety of definitions of engagement

Interviewees were themselves somewhat dissatisfied with the variety of definitions of engagement used by their peers and recorded as an “engagement” in their public disclosure of engagements in, for example, their annual PRI reports. Many interviewees stating that they themselves would not count a (random) email, telephone call or even initial company letter as an engagement, but that the actual purposeful meetings or dialogues with companies would be recorded as such. While others outlined their belief that a strongly worded letter from an investor can sometimes be just as effective as a one-on-one meeting with companies, especially if they are resource constrained.

Some interviewee organisations have begun to explicitly outline that engagement forms an important part of their overall ESG integration strategy and approach

In general, interviewees raised a lot of interesting points about current interpretations of engagement, especially its relationship with the evolving understanding of, and expanding scope and activity around, the notions of fiduciary duty and stewardship in the industry, as will be discussed again later in the Findings section. Quite importantly, we also noticed that some UK interviewee organisations in particular have begun to explicitly outline that engagement forms an important part of their overall ESG integration strategy and approach in their RI and/or stewardship policies and reports. Our analysis of interviewee engagement-related policies and statements allowed us to develop the first main component of our typology of engagers, as outlined in the table below (see also our complete typology on page 41 of this report).

“Integration and engagement are mutually reinforcing; company analysis drives engagement and engagement outcomes influence the analysis. This is why we have chosen not to separate proxy voting, engagement or ESG research into specialised functions.”

UK asset manager interviewee,
extract from RI Report, 2015

Main differences in engagers' policies

Types of Engagers	Policy
Emergent Engagers	▪ Possibly no RI policy, or, RI policy underdevelopment ▪ No engagement policy, or, generic RI policy that provides a basic overview of engagement definition & approach
Compliant Engagers	▪ Standalone engagement policy, or generic RI policy that mentions engagement; may/may not specify strategy, definition & approach ▪ Materiality-focused engagement to satisfy clients
Purposeful Engagers	▪ Standalone engagement policy, or included in generic RI policy ▪ More likely to clarify strategy, definition & approach ▪ ESG issues/themes often specified to guide approach
- Culturally driven	▪ <i>Emerging from values & principles</i> ▪ <i>Focus on fiduciary duty & environmental & social impacts</i>
- Strategically driven	▪ <i>Emerging from ESG integration</i> ▪ <i>Focus on financial materiality</i>
Progressive Engagers	▪ Most sophisticated policy (not always standalone), clarifying engagement: strategy; definition; approach; ESG themes; management; recording of outcomes/impacts ▪ Engagement considered core part of ESG integration practices ▪ Predominantly materiality-focused to satisfy clients

Source: Sustainalytics & Cass Business School

Engagement process: Triggers

The triggers, or catalysts, for engagement vary across interviewee organisations, and also between investment cases/portfolio holdings internal to each organisation itself. Yet, some of the most common triggers mentioned by interviewees were the following.

External/reactive triggers

Influence of specialised ESG research providers such as Sustainalytics

The majority of interviewees outlined that external ESG event, incident or controversy alerts issued by specialised research providers greatly influence engagements. For instance, information about a company's breach of Global Compact compliance, or controversy alerts related in particular to company controversial weapon activity, as provided by Sustainalytics, can automatically trigger an engagement for some investors. In addition, interviewees explained that client or beneficiary interest in the materiality of environmental and social issues, or specific requests for ESG-related engagement, are playing an increasingly significant role in sparking engagements. Furthermore, Dutch and UK interviewees mentioned that (soft) regulatory requirements such as the Eumedion guidelines in Netherlands and the UK Stewardship Code have also

Role of (soft) regulatory requirements

influenced the more recent expansion, and in particular accountability, of their engagement efforts beyond governance issues per se. Brokerage reports as well as non-governmental organisation (NGO) RI campaigns, such as those of ShareAction, continue to contribute to the development of specific thematically oriented environmental and social engagements.

"We utilise the services of external ESG research providers, they give an overall rating to a company, which we use as a signal, we will always drill down below that overall rating and look at the underlying metrics and with additional research, we identify engagement opportunities from that ..."

(Large UK asset owner)

Internal/proactive triggers

ESG research conducted by internal ESG or RI teams is the predominant stimulant for proactive environmental and social engagements

In terms of internal and more proactive catalysts for engagement, we found that the organisational culture and values of sustainable or ethical institutional investors in particular play a fundamental role in both triggering and determining the scope and nature of proactive engagement activities. Furthermore, interviewees repeatedly explained that ESG research conducted by internal ESG or RI teams, especially in larger, more ESG-resourced and experienced organisations, or sustainable/ethical firms, is currently the predominant stimulant for proactive environmental and social engagements. In a large number of cases, this is interrelated with fund manager interest or requests for (more) ESG information from ESG analysts to inform their thematic and fundamental analysis of certain sectors or companies, which is also highly reflective of ongoing investor appetite for better quality ESG disclosures by (potential) investee companies, and has been one of the most common motivations for ESG engagement in recent years. Finally, interviewees also outlined that ESG issues may arise during the course of regular company meetings

"They [fund managers] generally just walk over to me and say 'I watched a TV programme on antibiotic resistance, we own lots of pharmaceutical companies, let's talk' [...] And of course there's lots of engagement around that".

(Large UK asset manager)

between fund managers or financial analysts and investee companies, which can also trigger further ESG-specific dialogues.

Interviewees were keen to stress, however, that it is quite often a combination of a number of the above external/reactive and internal/proactive factors that contribute to the initiation of an engagement, which interviewees also explained is highly dependent on the (potential) size of their holding, severity of the ESG²¹ issue and level of exposure to associated risks, as well as their likelihood of engagement success.

Nevertheless, some distinct patterns emerged in our interview data. For example, we found a **reactive approach** is more likely to be taken by:

- (1) Smaller, less ESG-resourced institutional investors;
- (2) Institutional investors in the early stages of implementing an engagement approach; or
- (3) Asset managers taking a more “engagement overlay” approach, where ESG analysis and dialogues are considered an addition to existing company analysis and meetings, as opposed to integrated or specific dialogues in themselves.

“Sometimes the dialogues are reactive to an [ESG] incident. [...] and sometimes we take a proactive approach because when we notice that a particular event has happened at one of our investee companies we start to have a dialogue with other companies in that particular sector to see what policies and practices they have in place to prevent those events from happening [with them].”

(Dutch asset manager)

In most of these cases, reactionary approaches are not structured around pre-determined ESG themes for engagement, are very much bottom-up focused, and primarily act in response to external client, market, regulatory or civil society triggers.

Secondly, we found that a **proactive approach** is more likely to be taken by:

- (1) Sustainable/ethical institutional investors;
- (2) Larger, more ESG-resourced and/or experienced asset managers;
- (3) Passive asset managers, especially those working on behalf of pension funds, who do not have the luxury of the buy-sell strategies employed by active managers to meet clients’ universal ownership requirements for long-term value creation;
- (4) Asset managers, some UK in particular, who wish to establish and maintain long-standing relationships with investee companies to, for example, increase the likelihood of engagement success in future; and
- (5) Institutional investors, primarily French, who deliberately seek to inform their ESG integration efforts.

Quite remarkably, some interviewees mentioned that they are witnessing an increase in the number of companies that are now directly reaching out to them to discuss ESG issues following particular incidents.

The analysis of interviewee responses to our questions about the triggers for their engagements allowed us to develop the second main component of our engager typology (see table below).

Developing the second main component of our engager typology

Main differences in triggers for engagement by engager type

Types of Engagers	Triggering Process
Emergent Engagers	▪ Post ESG controversy (likely ESG research provider driven) ▪ Regulatory driven ▪ Market pressures ▪ Reactive
Compliant Engagers	▪ Client pressures/influence ▪ Regulatory pressures ▪ Compliance with industry standards ▪ ESG controversy/performance driven (via ESG research providers) ▪ Reactive
Purposeful Engagers	▪ Internally driven and/or ESG controversy/performance driven (via ESG research providers) ▪ Primarily proactive
- Culturally driven	▪ Internal ESG standards & research ▪ Client and/or beneficiary preferences
- Strategically driven	▪ Market movements & demands ▪ Internal ESG research driven
Progressive Engagers	▪ Strategically driven to conciliate ESG & financial performance; at forefront of market ▪ Client/beneficiary preferences ▪ ESG controversy/performance (research provider influence), as well as internal ESG research driven ▪ Both reactive & proactive

Source: Sustainalytics & Cass Business School

ESG research provider influence

ESG research providers are having an important influence in the initial stages of engagement

It is interesting to note that interviewees confirmed the important influence ESG research providers are having in the initial stages of engagement, even if their data *alone* may not initiate an engagement. The majority of interviewees outlined that they use a variety of data from a number of ESG research providers, which is uploaded to an internal database, and combined with internal ESG research and preferences (weights) to form proprietary tools such as a “Dashboard” or “Heat Map” to, for example, highlight stocks in the “red” territory for further attention and probable environmental and social engagement. These databases are, at least in the larger and more ESG-resourced or experienced organisations, normally accessible by all financial analysts and fund managers, where in some cases a tab to the integrated ESG data is the first thing that appears on their screen in the morning.

“I say there’s three reasons for engaging. One is fact-finding, one is monitoring and one is influencing.”
(UK asset manager)

In those organisations adopting a more structured or embedded approach to engagement, information gathered throughout the engagement process, and in particular that related to the outcomes and “successes/milestones” achieved at the

Link to integration: Engagement processes help organisations gain more in-depth knowledge about the ESG performance and associated risks of (potential) investee companies

end of an engagement, are fed back into these same databases (or specific engagement databases used in unison with them) on a regular basis. This is in order to enhance internal (ESG) knowledge of the sectors and companies involved so as to assist future engagements and ESG integration efforts. Some French organisations in particular have proactively structured their engagement approach around their desire to inform their ESG integration efforts, to, for example, gain more in-depth knowledge about the ESG performance and associated risks of their (potential) investee companies to compare with external, and enhance their own in-house, sector and company ESG research.

Engagement process: Management & execution

Engagement design and approach

Many asset managers are taking a thematic approach to engagements

“We take a thematic approach [...] because in our responsible investment policy we also state that we expect investee companies to live up the UN Global Compact Principles.”

(Dutch asset manager)

Further to the triggers for engagement outlined earlier, a mixture of top-down sector and/or thematic analysis, as well as bottom-up company analysis, appears to influence the initial engagement design and approach in interviewee organisations. Many asset managers, particularly in the Netherlands, but now increasingly more so

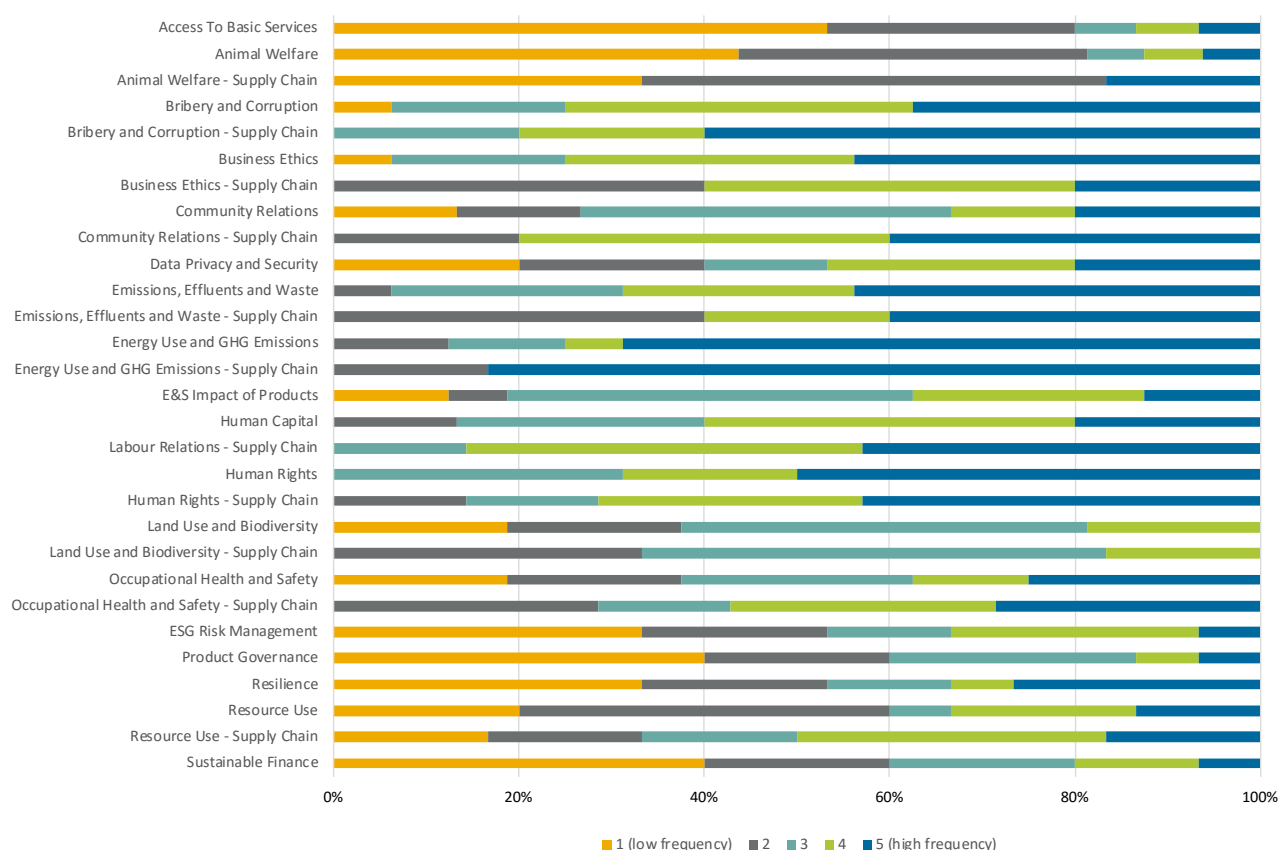
in the UK, are taking a thematic approach to engagements, prioritising specific ESG themes, often on an annual basis, that they believe are most material to them. The themes are often determined with clients directly or with client ESG preferences in mind.

Some of the most topical themes used to structure engagement across interviewee organisations include Energy Use & GHG Emissions, Bribery and Corruption, Labour Relations and Human Rights (see chart below). Setting clear ESG themes for engagement is normally done in an effort to focus the engagement approach and maximise resources (especially in asset managers with small ESG teams), but is also perhaps indicative of increasing shift towards more proactive engagement strategies.

Engagement objectives are normally developed on a case-by-case basis by either the ESG analysts, or the ESG analysts in unison with financial analysts or fund managers

In turn, the nature of the engagement trigger, as well as the organisations' (reactive/proactive) engagement strategy, both influence the specific objectives for engagement. Interviewees explained how engagement objectives, when they are set, are normally developed on a case-by-case basis by either the ESG analysts, or the ESG analysts in unison with financial analysts or fund managers. In some cases, engagement themes and objectives may also be developed in consultation with clients and/or beneficiaries. This is especially the case for engagements outsourced to engagement service providers, but also where asset owners are actively involved in the RI or engagement mandate of their asset managers.

Most frequently engaged-upon ESG issues (responses in %*)



*based on 19/36 interviewee responses

Source: Sustainalytics & Cass Business School

Mainstream asset owners appear to have limited interest in setting specific engagement objectives and targets

In many cases, however, our analysis shows that mainstream asset owners appear to have less interest in setting specific engagement objectives and targets, as they prefer to leave asset managers to proceed with the business of managing their assets, and trust that environmental and social engagement is a core part of that process. We feel it also important to point out, that some interviewees – also coming from experienced engager organisations – explained they may deliberately not set explicit objectives or “measurable” targets for individual engagements upfront, preferring in some cases for these to emerge throughout the course of the dialogue itself. This may be the case if a long-standing and trusting relationship is established, or in the process of being established, with the investee company in question.

“We want to hear from clients more than we currently do. There are many engagement themes that impact upon every client from the man on the street to the biggest pension fund, such as antibiotic resistance, cybersecurity or a global decline in pollinators and what that means for crop security.”

(Large UK asset manager)

Engagement is a resource-intensive activity

Preparation & form of engagements

The majority of interviewees conducting their own internal engagements emphasised that this is a resource-intensive activity. For instance, interviewees outlined that engagements often require a substantial amount of preparation on their part, normally entailing extra research to ensure all of their facts are in order about a particular ESG-related situation before approaching a company for engagement. In most cases, this involves background checks of ESG research provider data with a range of additional sources. Proactive engagements were found to be particularly challenging in this respect, especially for smaller or less experienced ESG teams.

ESG dialogues may be treated as an overlay to ongoing asset manager-investee company meetings

Modes of company interaction

Once the rationale and objectives for engagement have been decided, and preparations are complete, the manner in which interviewee organisations proceed to contact companies appears to be universal. That is, companies are normally contacted via email, letters and/or telephone calls to inform them of the asset manager and/or relevant clients' desire to discuss particular ESG issues. In certain instances, specific objectives and targets for engagement may be outlined at this stage. This is before actual engagement "dialogues" or meetings take place (if they are to take place) between ESG analysts and companies, with or without their financial analyst colleagues. However, some interviewees stated that this may not always progress in such a clear-cut, linear fashion. For example, as mentioned earlier, ESG dialogues in particular may be treated as an overlay to ongoing asset manager-investee company meetings, as opposed to independent dialogues in themselves. With regard to the latter, some interviewees, asset owners in particular, wondered whether an overlay approach to engagement by asset managers may, in some cases, be indicative of a perhaps less coordinated or committed approach to broader ESG integration efforts.

"It is always a joint effort, and whenever I have a dialogue or an engagement with a company, we always inform the [financial] analysts and ask for their perspectives and their view on the particular issue at hand. Or we really do a joint meeting or joint conference call."

(Dutch asset manager)

Choosing who to engage with

Creating a "halo effect" throughout the sector

In general, engagements appear to be carried out by the majority of interviewees both in the initial development of a company investment case pre-investment, as well as part of the ongoing monitoring and valuation of that asset post-investment. Quite importantly, companies that are poor ESG performers are not the only ones engaged with. Many interviewees outlined that they find it very beneficial to also engage with companies considered "ESG leaders" in their sector to understand their strategies, programmes and procedures in more detail in order to inform their engagement objectives and targets with other companies in the sector, thus proactively creating a "halo effect" throughout the sector, as one Dutch interviewee referred to it.

Interviewees agreed that who they engage within the companies can have an impact on the progression and ultimate “success” of the engagement

“Typically we raise our questions at the board level to begin with. But what you see in practice is that the board is very interested in a dialogue with investors on corporate governance-related issues. But whenever you try to discuss sustainability-related issues ... I mean they are certainly open to that. But what I notice is that sometimes you are referred to a sustainability manager inside the firm, typically they do report themselves to the board. But in order to realise change, and certainly within a reasonable timeframe, it’s always better to have the dialogue immediately at the board level.”

(Dutch asset manager)

Interviewees explained that who is contacted in the company is largely dependent on the issue of concern. For example, if it is a governance issue, it is normally members of the board of directors, while environmental and social issues may be better dealt with by specialised managers (to whom access may be restricted). Interviewees agreed that who they engage within the companies can have an impact on the progression and ultimate “success” of the engagement, with board members able to expedite engagement processes more quickly or efficiently than managers would, and with engagers ultimately needing board-level buy-in and support in order to advance

engagement objectives internally regardless of whom they initially engage. Many experienced engagers, especially engagement service providers, outlined the advantage of (strategically) establishing long-term relationships with senior management and board members in this respect, so as to be able to contact them directly for engagement purposes.

Engagements can become more complicated due to various language barriers and cultural differences

Interviewees also outlined that engagements can become more complicated when operating internationally, due to various language barriers and cultural differences. For example, both a Dutch and French interviewee mentioned that engagements in Japan can be particularly challenging due to a tradition of corporate non-disclosure there.

Engagement timelines

On average, engagement cycles tend to run from 1–3 years, 3–5 years or even beyond that for very serious cases, such as the BP oil spill

Furthermore, the majority of interviewees explained that they do not always set specific timelines for their engagements at the beginning of the company dialogues. In most cases these seem to be somewhat “rolling”, dependent on the level of responsiveness of the companies, the severity of the ESG issues involved and the companies’ progress addressing engagement objectives. Interviewees did comment, however, that for some of the less severe, more approachable and perhaps more easily measurable environmental issues, engagement cycles may typically be a year, in order for any changes made by the investee company to be reflected in their (sustainability) reports the following year. In addition, one Dutch sustainable asset owner interviewee explained that he normally decides to continue with an engagement or not (and in extreme cases a divestment) based on a company’s progression with the terms of the engagement after one year. Yet, on average, engagement cycles tend to run from 1–3 years, 3–5 years or even beyond that for very serious cases, such as the BP oil spill.

“There is the tragedy of the horizons [...] It might take a company a long time to prove [themselves] and then investors are already interested in something else.”

(French asset manager)

Some interviewees do not even separate the ESG and financial analyst functions, with investment analysts expected to incorporate both into their daily operations

Management & responsibility for engagements

The management and responsibility for engagements differs across interviewee organisations, and is often dependent on the size and structure of the ESG teams, as well as their level of interaction with their investment analyst colleagues. A number of interviewee organisations separate governance and environmental and social teams, and others keep them as one. Some interviewees do not even separate the ESG and financial analyst functions, with investment analysts expected to incorporate both into their daily operations. The majority of interviewee organisations, however, are operating with ESG, or separate Governance and environmental and social teams, of various sizes, ranging from 1 to 30 members, but with an overall average size of approximately 3–6 members per ESG team. It is these ESG teams that conduct most environmental and social engagements, many in unison with relevant financial analysts or fund managers, and therefore have the responsibility for managing engagements, unless a fund manager seeks to take the lead on an engagement. In the case of the latter, one of our UK asset manager interviewees outlined that the organisation's ESG analysts will provide a list of ESG issues that should be addressed in the meeting and a list of "acceptable" responses from the company, and also expect the fund manager to report back to them on this following the meeting in order to agree upon next steps together. This is part of an approach another of our interviewees has referred to as "integrated engagement".

Many ESG teams are now housed on the same floor as the financial analysts

Collaboration between ESG & financial analysts

Many of these ESG teams, especially in the UK, are now housed on the same floor as the financial analysts, with some of them literally sitting side by side. Interviewees explained that these recent moves to bring them together were to facilitate ESG integration efforts, and have had very positive results. For example, many interviewees explained that they now have almost daily, informal interactions with financial analysts and fund managers across the floor about a range of ESG, and in particular engagement, issues, which cuts down on the need for formal meetings between teams, and makes ESG

"Very much the emphasis is on integrating this, we think it's absolutely key to move away from a siloed, separate [ESG] team to working closely with all of the different investment teams. And that's reflected by the dramatic increase in knowledge of these issues across the different teams [...] Structurally, having [name of ESG analyst] on the investment floor – so a sustainability guy's being absorbed into the investment strategy – is profound."

(UK asset manager)

discussions part of the daily investment routine. In instances where the teams are still separate, or even when governance and environmental and social teams are kept separate, there also appears to be regular interaction and meetings between them. Yet, it should be noted that all of this appears to be most advanced in the UK at present.

Level of “resistance” from financial analysts has decreased in recent years

In general, however, interviewees from all three countries explained that the level of “resistance” from financial analysts to them (ESG/RI analysts) and their work has decreased in recent years. And while still a work in progress, there appears to be far more willingness to work together, especially through engagements, as many of these activities, such as meetings with brokers and/or board members, fit naturally with the daily fund manager practices.

Engagement service providers take a structured approach to their engagement planning, execution and management

Movement towards a milestone approach?

Overall, we found that our engagement service provider interviewees take the most structured approach to their engagement planning, execution and management, that is, through the establishment of specific engagement milestones and related objectives/targets, recording of results/outcomes, as well as particular timeframes for engagement cycles.

The rest of the interviewees have some variant of the four-step milestone approach in action, but it is not always “formalised” as such

This milestone approach encompasses: **(1)** informing the company of their/their clients’ concerns, by raising it at the appropriate level within the company; **(2)** the company’s acknowledgement of the concern and agreement that it must be addressed;

“With regard to setting objectives for engagement, some of the engagements we undertake are intended to build relationships and improve our understanding with the firm’s business model, risks and strategy as a result. In some instances, the intention may not be to influence a particular behaviour or activity, and the objectives may be less specific. On other occasions there will be more clearly identified objectives against which progress can be tracked.”

*Large UK asset owner interviewee,
extract from PRI report*

(3) the company’s development of a meaningful plan to address the concern; and **(4)** the company’s demonstration that the plan has been successfully implemented to overcome the concern, the latter being indicative of an engagement “success”. One of our engagement service providers also regularly does quality checks of its engagers, and even asks external, independent parties to contact the companies being engaged for their feedback on the process. The rest of the interviewees have some variant of the four-step milestone approach in action, but it is not always “formalised” as such, for example through an internal policy, and/or does not always transpire in such a linear

fashion. However, this does not necessarily mean that a less formal structure is less effective or efficient. Our analysis of interviewees’ approach to the management and execution of their engagements allowed us to develop the third main component of our typology (see table below).

Main differences in engagers' execution & management of engagement

Types of Engagers	Execution and Management
Emergent Engagers	▪ One RI manager, very small or no ESG team responsible for engagement ▪ Little interaction between ESG & fund managers in planning & execution ▪ Objective & targets may not be set ▪ Engagements may take the form of emails/letters/phone calls only
Compliant Engagers	▪ Small to large ESG team; may/may not work with fund managers to plan and/or conduct engagement; limited ESG integration "loop" ▪ Objectives & targets normally set ▪ ESG engagements are often an "overlay" to regular company meetings with companies
Purposeful Engagers	▪ Small, dedicated ESG team, working closely with fund managers to plan and/or conduct engagements ▪ Special ESG engagement dialogues beyond regular company contact/meetings
- Culturally driven	▪ Objectives & targets not always set; but clear ESG purpose for company dialogues ▪ "Integrated engagement" a natural process
- Strategically driven	▪ Objectives & targets not always set; but clear materiality orientated purpose for dialogues ▪ Strong ESG integration feedback loop
Progressive Engagers	▪ Large ESG team working closely with fund managers to plan and/or conduct engagements; ESG integration & engagement feedback loop well established ▪ Specific engagement milestones, objectives, targets & timeframes set ▪ Beyond initial contact, strategic ESG dialogues conducted with companies (mainly with board/senior managers); often to enhance/maintain long-term relationships

Source: Sustainalytics & Cass Business School

Engagement process: Monitoring, evaluation & recording

One of the most important ways to monitor whether engagement objectives have been achieved is if the company is reporting the change in their sustainability or integrated reports

Interviewees explained that the most frequent way they monitor the progress of investee companies against engagement objectives is through ongoing meetings with companies, which, depending on the severity of the issues, may or may not be scheduled regularly. In addition, some interviewees outlined that companies are now beginning to contact them directly to inform them of changes made and objectives being met. Nevertheless, interviewees also emphasised that one of, if not the, most important ways for them to monitor whether their engagement objectives have been achieved is if the company is reporting the change in their sustainability/integrated reports. Many interviewees highlighted that the company's verbal claim that the change has been made is not sufficient enough alone. It is extremely rare, if not totally non-existent, however, that interviewees actually pay site visits to the companies to check whether at least some of the more tangible environmental and social changes have actually been made (see further discussion on impacts below).

Asset owners, and asset managers who outsource (part of) their engagements, are very much dependent on the outsourced engagement provider/asset manager when it comes to the monitoring and evaluation of engagement progress, as well as success. The outsourced party, and asset managers in general, are therefore tasked with providing their asset owners and clients with regular, normally quarterly, reports on engagement activities and progress. In one of our engagement service provider interviewee organisations, clients also have access to an online portal whereby they can track the progress of the engagements directly.

“One challenge, and it would be useful if data providers could help with this, is the monitoring and managing of follow-ups with companies and the tracking of their progression.”

(Large UK asset manager)

Fossil fuel divestment campaign has sparked a lot of interest from clients and beneficiaries

Dealing with unresponsive companies

“The fossil fuel divestment campaign is obviously a big one, and we do get questions often from our beneficiaries asking what we’re doing on this, and we’re not a divestment house, so we’ll always say we’ll engage.”

(UK asset manager)

In the cases where companies are being unresponsive or slow to progress with engagement objectives, interviewees explained that they will often either intensify engagement efforts, reduce their expectations and develop more feasible expectations of the company, and/or extend their engagement timeframe, or enter into collaborative engagements with other investors to increase the likelihood of effecting change in the company. This

is largely dependent on the company, the issues at hand and the importance/size of the investor’s holding.

Divestment is viewed as the last resort, and seen as an appropriate response to some severe environmental and social cases, such as Volkswagen

In addition, interviewees outlined that their commitment to engaging with companies meant that they viewed divestment as a last resort. For example, many active asset manager interviewees in the UK in particular mentioned that the fossil fuel divestment campaign has sparked a lot of interest from their clients and beneficiaries. They explained that they have taken the time to outline to clients and beneficiaries that divestment is not the only option available, and engagement can, in some cases, be a more favourable and effective approach.

In general, interviewees made clear that divestment is viewed as the last resort, and seen as an appropriate response to some severe environmental and social cases, such as Volkswagen. Even sustainable asset owners and manager interviewees agreed that divestment decisions are not taken likely and are rare. However, one ethical asset manager did point out that this was, in their case, indicative of the quality of their initial ESG screening process: “But divestment is very rare, we’ve done two in my five years here. And maybe approaching a third. But that’s a very, very small ... and I take that actually as quite a tribute to the quality of the screening process. So the companies we choose hopefully are quality companies that don’t get into trouble, deliver financial value but are delivering sustainability value as well.”

Recording progress and outcomes

There are a variety of ways that interviewee organisations are recording investee company progress against their engagement objectives or targets. The most frequently

Variety of ways that interviewees are recording investee company engagement progress

occurring include sometimes a mix of informal meetings logs/notes from ongoing company dialogues, and more structured engagement databases, either standalone or part of one large ESG database. Based on interviewee descriptions, some of the more advanced engagement databases track, for example:

- Engagement objectives;
- Number of client meetings;
- Company progress against objectives;
- Engagement timelines;
- Reminders of when a follow-up meeting is due to take place;
- Outcomes of engagement/objectives achieved or not; and
- Important notes for possible future engagement or ESG integration efforts.

Interviewees informed us that this information was then fed into core ESG databases for access to all financial analysts or fund managers for future investment cases, with two large UK asset managers outlining that they are now also attempting to track changes in (proprietary and external research provider) company ESG scores in the aftermath of their engagements in these databases.

For many interviewee organisations, the “feedback loop is not well defined”

However, it should be noted that this is primarily occurring in some of the more advanced engager organisations currently, and even then, these ESG integration efforts are still a work in progress. For many other interviewee organisations, the “feedback loop is not well defined”, as one Dutch interviewee remarked. Nevertheless, the interrelationship between engagement and overall ESG integration efforts is being recognised and is beginning to be operationalised.

A form of “soft” integration is currently occurring

We would also like to emphasise, that while explicit, formal integration through such databases may still be developing, interviewee discussions lead us to believe that the more implicit, tacit knowledge created by engagement activities, for both ESG and financial analysts, is inevitably informing their ongoing approach to investment decision-making at present; therefore, a form of “soft” integration is occurring (see also the “value of engagement” discussion, page 37).

Challenges recording a success

The vast majority of interviewees explained that it can be very difficult to pinpoint and record specific changes that have been made due to their engagements

“It’s not easy [...] engagement is very much a qualitative process. You can of course try to make it quantitative but you still have judgment calls to make. I think the best thing you can do is make it very specific and say okay, these are my five clearly defined objectives, and for these five objectives I use these KPIs to see if there’s progress.”

(Asset Manager &
Engagement service provider)

Furthermore, quite importantly, the vast majority of interviewees explained that it can often be very difficult to pinpoint and record specific changes that have been made due to their engagements and therefore an engagement “success”, especially if they are not concerned with tangible, quantifiable, environmental objectives such as changes in water or energy use. All of this appears to be somewhat easier for our engagement

service providers, who take a structured, “milestone” approach, and set clear engagement objectives to be monitored and recorded. For example, one of our

engagement service provider interviewees explained that if 3 out of a total of 5 objectives have been adequately met, and if they feel that the others may be met in the future, or are no longer relevant, then they will record the engagement as a “success”. But even they too mentioned the challenges at hand, despite their use of sophisticated in-house tools to track engagement progress and outcomes. In the majority of cases, in both service providers and the large asset managers, interviewees explained that they have active debates with colleagues to determine whether a particular objective, target or milestone has actually been achieved, and thus whether an engagement could be closed and considered a “success”.

Many interviewees view the notion of a “successful” engagement as often being broader than achieving the original objectives they may have set for the engagement

“We do not feel that we can actually tell that a company moves forward thanks to us [alone].”

(French asset manager)

In addition, apart from engagement service providers and a few large asset managers, institutional investors do not always have a formalised process to record a success. In fact, many of them view the notion of a “successful” engagement as often being broader than achieving the original objectives they may have set for

the engagement. For example, as one UK asset manager interviewee commented: “If we come away from an engagement thinking that we have improved our knowledge of a company or a sector, that’s a successful engagement for us.” Another of his colleagues elaborated that: “Measuring the success of engagement might not necessarily be the company changing its action [...] As investors, we want to improve investment outcome and we’ll have got better insights into the capabilities of the management, their abilities, how they’re managing an issue [so] often that, in many cases, is the most successful outcome [of engagement].” This was echoed by a French asset manager: “The feeling you have of the dialogue is very important.”

ESG integration can be enhanced through ESG analyst diffusion of knowledge within internal investment teams

Indicating that the impression of, and knowledge gained about, a company through a dialogue can be key in the development of a relationship with them and an indicator of engagement outcomes in future. Furthermore, as alluded to earlier, many interviewees outlined that their engagement activities have increased their ESG knowledge to allow ESG/RI teams in particular to

“Due to the knowledge and the expertise that the engagers have gathered in this time of working on different issues [...] we [RI team] have become some sort of a knowledge centre for the whole organisation.”

(Dutch asset manager)

become an internal hub of expertise, which can directly enhance ESG integration through their interaction with internal investment teams, and is thus indicative of another successful outcome of engagement. Therefore, the whole definition of success in itself is also very subjective, and needs further attention (see also the “value of engagement” discussion, page 37).

Attribution of success

It’s difficult to attribute an environmental or social “success” to particular engagements

Another fundamental issue is the fact that all interviewees involved in internal (and even some involved in external) engagements stated that it is very difficult to attribute an environmental or social “success” to their particular engagements, and therefore measure their impacts. This is because, inter alia, it can take many years for the environmental and social change or benefit to materialise, and there can be a myriad

of other factors that influence that change beyond their engagement alone. Hence, while interviewees offered various examples of where they felt their engagements had contributed to changes in company behaviour, which lead to positive environmental and social impacts, such as:

- the pioneering transformation of the use and marketing of breast milk substitutes;
- the reduction of harmful impacts of tailings from copper and gold mining in Indonesia;
- improvement in labour conditions in Asian electronic companies;
- the preservation of world heritage sites;
- awareness and avoidance of human trafficking in supply chains; and
- improved company disclosure of their exposure to stranded asset risks.

They were keen to point out that they could not always attribute successful outcomes directly to their engagements alone, especially as companies are often engaged by a number of investors at the same time.

The tracking of specific environmental and social impacts might be possible for asset managers dealing with smaller, more concentrated portfolios

One asset owner interviewee mentioned that the tracking of specific environmental and social impacts might be possible for asset managers dealing with smaller, more concentrated portfolios, where there is a better chance of actually identifying, recording and measuring their engagement impacts in financial terms, and which one of their specialised asset managers is currently attempting to do with regard to carbon across 22 holdings. But this is far more complicated and resource intensive for large asset managers to do, due to the number and diversity of their portfolios. The table on reporting trends in the following section (see page 34) gives an indication of how difficult this may be, due to the reported number of individual engagements conducted by a sample of our interviewees in 2015 alone.

Changes that have been recorded in interviewee PRI reports often relate to more easily “measurable” outcomes

Given the complexity of tracking specific engagement impacts and the subjective nature of determining whether an engagement has been successful or not, interviewees highlighted that it can therefore be challenging to report upon the number of engagements that they deem successful, or rather, the number of changes a company has made to its practices due to their engagements. The latter has been prompted by (voluntary) indicators LEA 13.1 and LEA 13.2 in the PRI Reporting Framework.²² As a result, those company changes that have been recorded in interviewee PRI reports in particular often relate to more easily “measurable” outcomes from specific engagement objectives related to changes in company policy or enhanced levels of disclosure (see further discussion about accountability in the next section).

Overall findings tend to challenge current academic and practice research on the valuation of engagement

In general, these overall findings tend to challenge current academic and practice research on the valuation of engagement that seek to prove the almost simplistic, linear progression and positive correlation between engagement and upwards trends in company ESG and financial performance.²³ The complexity and subjectivity of engagement processes makes any objective quantification of engagement “success” particularly problematic.

Our analysis of interviewees' approach to the monitoring, evaluation and recording of their engagements allowed us to develop the fourth main component of our engager typology (see table below).

Main differences in engagers' monitoring, evaluation & recording of engagements

Types of Engagers	Monitoring, Evaluation & Recording
Emergent Engagers	▪ Less mature (structured/formalised) approach to monitoring, evaluating & recording company progress with engagements ▪ May not have database to assist
Compliant Engagers	▪ Mature (structured/formalised) approach to monitoring, evaluating & recording progress against engagement objectives & targets; & final "success" ▪ Single engagement database to assist; may not feedback into main ESG database
Purposeful Engagers	▪ May not have very mature approach to monitoring, evaluating & recording engagement progress & "success"; but natural ESG integration feedback loop
- Culturally driven	▪ May/may not be a single engagement database; normally one main ESG database to assist & capture feedback
- Strategically driven	▪ Normally not a single engagement database, but one proprietary ESG integration database to record feedback
Progressive Engagers	▪ Most mature approach to monitoring, evaluating & recording engagement progress, milestone achievement & "success"; incorporating regular internal "engager" quality checks, as well as team debates ▪ Sophisticated proprietary tools to assist & also feedback engagement data into main ESG integration database ▪ Client online portals to check progress

Source: Sustainalytics & Cass Business School

Engagement impact, outcome & value creation

Accountability

Private reports to clients provide more detailed information than publicly available reports

Our institutional investors view themselves as being first and foremost accountable to their clients and beneficiaries for the impact and outcome of their engagement processes, and secondly to broader stakeholders such as regulators (e.g. financial authorities responsible for stewardship codes), standard setters (e.g. the UN PRI) and civil society. Their accountability practices reflect this through, for example, asset manager production of both private (client) and public reports on their engagements activities on a quarterly and annual basis, as well as asset owner and manager production of specialised annual reports to meet UN PRI, the UK Stewardship Code and additional reporting requirements. Private reports to clients normally tend to provide more detailed information than publicly available reports. For instance, a list of the number and names of companies engaged with may be updated on a quarterly basis for the public disclosures, but is not always accompanied with information on why these companies are being engaged with, what the status of the engagement is or what the outcome of the previous list of engagements has been.

“We do provide reports to clients, they’re more comprehensive than the public reports. However, we don’t publically report on all of our engagements. I can see benefits and drawbacks of reporting on all engagements all the time. Sometimes privacy helps the process. We don’t put a press release out after every engagement, unlike some investors.”

(Large UK asset manager)

Great disparity in the content and quality of institutional investor disclosures both amongst and across our three countries

It should be noted however, that publicly available annual engagement reports tend to provide more detail, but as noted in our Introduction, there is great disparity in the content and quality of institutional investor disclosures on their actual engagement processes, both amongst and across our three countries (see table below). This is often reflective of the institutional investors’ desire to protect the details of their relationship with investee companies, but can also be influenced by the current format of standardised reporting frameworks, such as the PRI, which, based on interviewee responses, we are led to believe some are treating as a tick-box exercise at present. In turn, inconsistent levels of disclosure are increasing civil society actor requests for institutional investors to be more transparent and accountable for the environmental and social impacts of their investment and engagement activities. For example, in their recent survey of UK institutional investor engagement disclosures, the non-governmental organisation ShareAction highlights that only half of survey participants outline a clear process for research into and monitoring of their investee companies (see chart on page 35).

Engagement disclosures

While investor disclosure in the UK and the Netherlands traditionally tended to surpass that of France, the number of individual engagements being conducted in France has greatly increased in recent years

In general, we found that more experienced (not necessarily larger) engagers, sustainable/ethical investors and engagement service providers across the three countries tend to provide more detailed levels of disclosure about their engagement approach. In addition, while investor disclosure in the UK and the Netherlands traditionally tended to surpass that of France, statistics provided by the PRI suggest that the number of individual engagements being conducted in France has greatly

increased in recent years, and engagement disclosures have also accordingly increased. Furthermore, as can be seen in the table below, the majority of engagements conducted and reported by our selected interviewees across all countries are primarily governance oriented, but with an increasing amount of overlapping ESG engagements being recorded.

Indicators of engagement reporting across countries (2015)

Interviewee	Assets under Management	Number of individual engagements conducted 2015*	Breakdown of engagements 2015**	Number of company changes achieved in 2015***
Dutch				
<i>Largest</i>	EUR 417bn	175	45% governance; 14% social; 2% environmental; 39% (overlapping) ESG	76
<i>Medium</i>	EUR 187bn	35	23% governance; 6% environmental; 0% social; 71% ESG	2
<i>Smallest</i>	EUR 1.9bn	Private not disclosed	Listed as "n/a" in PRI report	Listed as "n/a" in PRI report****
French				
<i>Largest</i>	EUR 987bn	275	85% governance; 7% social; 3% environmental; 5% ESG	79
<i>Medium</i>	EUR 42.8bn	5	100% ESG	Private not disclosed
<i>Smallest</i>	EUR 3.5bn	150	15% governance 5% environmental; 5% social 75% ESG	Public but not reported
UK				
<i>Largest</i>	EUR 945bn	Private not disclosed	Private not disclosed	Private not disclosed
<i>Medium</i>	EUR 336bn	817	20% governance; 10% environmental; 10% social 60% ESG	Public but not reported
<i>Smallest</i>	EUR 3.04bn	330	40% governance; 30% environmental; 20% social 10% ESG	2
PRI consolidated reporting figures per country*****	(a) Total number of PRI signatories with listed equity in each country (LEA)		(b) Number of PRI signatories with listed equity that declare that they do individual engagements	
Dutch	54		40 (74%)	
French	58		44 (76%)	
UK	93		77 (83%)	

* Numbers of individual engagements reported (excluding collaborative engagements), in the "Listed Equity Active Ownership" section of selected interviewee PRI reports 2014/2015 (see PRI indicator LEA 11.1: "Indicate the number of companies with which your organisation engaged during the reporting year"). **Note:** all numbers relate to PRI "Listed Equity Active Ownership" indicators in selected interviewee PRI reports.

** As per PRI *voluntary* indicator LEA 12.2: "Provide an estimated breakdown by E, S and/or G issues."

*** Numbers reported against *voluntary* PRI indicator LEA 13.2: "Indicate the number of companies that changed or committed to change in the reporting year following your organisation's and/or your service provider's engagement activities." **NB:** Reporters are not requested to clarify whether these changes are environmental, social or governance related.

**** This interviewee does not report against this voluntary indicator and has listed it as "n/a" in the opening index of his report.

***** Figures kindly provided by the PRI. Column (b) corresponds to the PRI indicator LEA 02. Percentages represent the total number indicated in column (b) divided by the number provided in column (a).

Source: Sustainalytics & Cass Business School

Differences amongst interviewees within and across all countries regarding how engagement numbers are being recorded and counted

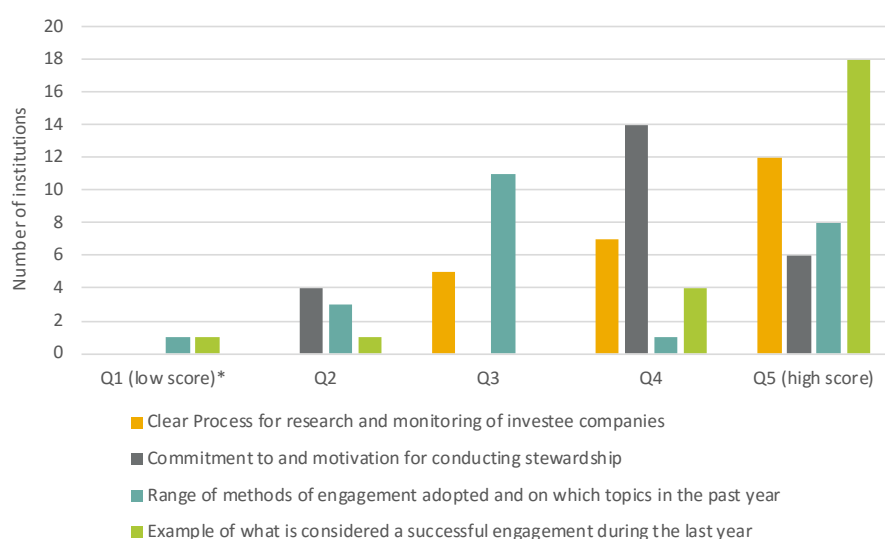
Despite the slow movement towards more standardised forms of engagement reporting, there are still differences amongst interviewees both within and across all countries regarding how engagement numbers are being recorded and counted. This directly relates to various interpretations of what an engagement actually is, as introduced at the beginning of our Findings section. For example, some interviewees record every interaction with a company as an engagement, and others only the specific ESG dialogues themselves. It should be noted, however, that the PRI Reporting Framework provides signatories with guidelines on what should and should not be recorded as an engagement in their reports. Nevertheless, not every interviewee clearly explains what their engagement numbers constitute in either their PRI or additional public engagement disclosures.

Preference to focus on quality as opposed to quantity of engagements

However, quite importantly, some interviewees also made it clear that they prefer to focus on the quality of the engagements as opposed to recording the quantity conducted per year, as they view the objective of their engagements as being more meaningful than merely setting out to achieve a targeted number of engagements annually. Due to all of the above, as well as the fact that engagements can often take many years before they can be considered to have effected a company change or “success”, the numbers taken from interviewee’s PRI reports in the table above as well as the results of ShareActions’ recent survey of UK institutional investor engagement disclosures (see chart below), should be read with this nuanced context in mind.

Transparency of institutional investor engagement

ShareAction survey: Only half of the responding organisations have reached a high level of achievement (above 80%) in outlining a clear process for research and monitoring their investee companies



* We display the numbers of companies within quintiles (Q1 to Q5). A quintile is determined based on the percentage of the achieved score relative to the maximum achievable score. In the lowest quintile, institutions have a degree of achievement of $\leq 20\%$, and in the highest quintile of $> 80\%$.

Source: Sustainalytics, based on ShareAction (2015)

Some interviewees are not interested in, nor do they see the value in, trying to prove the materiality of engagement in financial terms

Materiality of impacts and outcomes

“I used to work at [...], they started to invest more and more in these kind of activities. And all of a sudden, the question was raised: ‘well what do you actually contribute to alpha?’ So then we had to link all our dialogues and engagement successes to additional alpha and that was really an artificial exercise I must say.”

(Dutch asset manager)

As previously discussed, it can be very challenging for institutional investors to record, measure and therefore report upon the impact of their engagements, especially in environmental and social terms. Nevertheless, many of them, especially engagement service providers, have been attempting to do so by focusing on the financial materiality of engagement in particular in order to meet their fiduciary duty to clients and beneficiaries. Quite paradoxically, however, one of the most interesting things to emerge from our interviews is that a number of our interviewees

are not interested in, nor do they see the value in, trying to prove the materiality of engagement in financial terms. This means that they are experiencing the wide-ranging benefits of engagement on a daily basis, for example, related to enhanced ESG integration efforts as well as incremental improvements in investee company ESG performance, and hence intuitively feel that engagement is having positive material impacts to their investments. Therefore, they do not always think it necessary to quantify these impacts in financial terms.

A broader notion of fiduciary duty and stewardship was repeatedly cited by interviewees as their rationale for conducting engagements

In fact, the majority of our interviewees found this to be quite an arbitrary exercise, largely due to the inherent complexities and subjectivity of engagement processes as previously outlined. These interviewees explained that they do not see the financial valuation of engagements as a prerequisite to: **(1)** recognising the overall value of engagement; and/or **(2)** justifying why they are continuing to conduct engagements. In addition, many asset managers mentioned that they are also not receiving pressure from their asset owner clients to prove financial materiality. This is not to say that there is no asset owner interest, but this seemed to be less than we would have anticipated pre-interviews. A broader notion of fiduciary duty and stewardship, one which implicitly expands the scope of these concepts towards more holistic social accountability, was repeatedly cited by interviewees as their rationale for conducting engagements in the absence of tangible proof of the financial benefit of engagement.

It is the natural instinct of institutional investors to want to quantify their activities, yet in this case, it would appear to be (perceived) external market requirements that are causing the incessant drive to evidence and quantify the (financial) materiality of engagement, more than any internal organisational desire or necessity to do so. Our interview evidence suggests that in many cases, the overriding perception of the market need to value engagement in financial terms alone, is actually running counter to, and conflicting with, the daily, complex realities of engagement processes, and neglecting to recognise the broader non-financial/quantifiable “values” that our interviewees are currently experiencing due to their engagement activities.

Seven categories of value created by engagement

The “value” debate

Based on our interview evidence, it is obvious that the notions of “value” and “success” associated with engagements need to be unpacked, recognised and recorded in far broader terms than financial value and materiality alone. Hence, we have attempted to categorise and explain the range of values we believe to be associated with engagement beyond **Financial Value**. These include the following:

- **Stewardship Value** relates to the importance of engagement for institutional investors to fulfil their stewardship and fiduciary duties for their clients and beneficiaries, which can also enhance their broader social accountability and legitimacy.
- **Knowledge Value** relates to the increased internal ESG knowledge and expertise that engagement creates for investment decision-making, thus enhancing ESG integration.
- **Collaborative Value** relates to the closer collaboration and comradery between ESG and financial analysts that engagement facilitates, thus advancing ESG integration efforts.
- **Signalling Value** relates to the manner in which engagement can alert potential (investee) companies about the specific ESG issues, performance and disclosure that investors require of them.
- **Relational Value** relates to the ability for engagement to facilitate the establishment of long-term, trusting relationships with investee companies, which can increase the likelihood of engagement success.
- **Environmental and Social Value** relates to the potential direct and indirect benefits to the environment and society that can transpire from engagement activities; however, the monitoring and recording of this between institutional investors, investee companies and, where relevant, broader stakeholders, needs to be greatly improved.

Assisting institutional investors to better identify, monitor and disclose the range of values created by their engagement efforts

This overall categorisation allows for a more holistic understanding and representation of the notion of value associated with engagement, which can assist institutional investors to better identify, monitor and disclose the range of value created by their engagement efforts. In the table on the following page we describe how exactly the different values of engagement are created and who benefits from this.

Wrapping Up

A unique typology of engagement & engagers

Unlocking the black box of engagement

For many institutional investors, responsible engagement has been the answer to ensuring positive risk-adjusted returns for their investments, and thus long-term value creation for clients and beneficiaries in recent years. However, due to inconsistent levels of disclosure, we have been left somewhat in the dark with regard to the actual daily engagement practices of asset owners, asset managers and engagement service providers, and in particular, those related to direct environmental and social dialogues with investee companies. We have therefore attempted to unlock the black box of (environmental and social) engagement in this report, and in doing so, have showcased how and why engagement activities are interrelated with ESG integration, and create a range of value for institutional investors and their stakeholders.

Valuing engagement: Types of value created and related beneficiaries

Types of Value of Engagement	Definition of Value	Description of Value Creation	Beneficiaries of Value Creation
Financial Value	Value from increased financial performance of investee companies	Improving a firm's ESG performance through engagement is believed to increase its market value & enhance risk-adjusted returns	Benefit to institutional investors, their clients and beneficiaries in medium to long term
Stewardship Value	Value of fulfilling fiduciary duty and broader social accountability	- Engagement assists institutional investors to address their financial and extra-financial duties of care and stewardship - Engagement enhances the legitimacy of investors in the eyes of their clients, beneficiaries and broader stakeholders	Benefit to institutional investors, their clients and beneficiaries, regulators and broader stakeholders in the medium to long term
Knowledge Value	Value of knowing more about the investee companies	Engagement increases internal institutional investor ESG knowledge and expertise, which enhances investment decision-making and ESG integration	Benefit to institutional investors in the short/medium/long term
Collaborative Value	Value from enhanced collaboration between financial and ESG analysts	- Engagement allows for greater interaction and collaboration between ESG and financial analysts, facilitating the internal diffusion of ESG knowledge and advances in ESG integration - Closer collaboration between ESG and financial analysts through engagement helps to break down internal barriers	Benefit to institutional investors in the short /medium/long term
Signalling Value	Value from raising company awareness of investor ESG concerns/preferences	Engagement can alert (potential) investee companies to the types of ESG issues of most concern to, and levels of performance and disclosure desired by, investors	Benefit to investee companies and institutional investors in the short /medium/long term
Relational Value	Value of improved relations with investee companies	Engagement enables the development of long-term relationships with investee companies, which increases trust and the ability to successfully influence company ESG practices and performance	Benefit to investors and investee companies in the medium/long term
Environmental and Social Value	Value from the promotion of best ESG practices within companies	- Engagement promotes the adoption and diffusion of cutting-edge ESG strategies, practices and reporting within and across industries - Engagement has the potential to transform corporate behaviour to generate positive environmental and social impacts	Long-term benefits for institutional investors, their beneficiaries, regulators, broader stakeholders and the physical environment

Source: Sustainalytics & Cass Business School

Providing a benchmarking opportunity

More specifically, our in-depth analysis of interviews conducted with 36 UK, Dutch and French institutional investor representatives has allowed us to develop a unique typology of engagement and engagers, as well as their value creation. Both our typology and the associated categorises of value provide institutional investors with an opportunity to benchmark themselves against the ESG integration and engagement practices of their European peers, and to identify, monitor and disclose the range of

Optimism about the future of engagement across all three countries; cross-national consolidation of engagement practices expected

value created by their engagement efforts in a more holistic manner than is currently practiced (for a complete overview of our typology, see table on page 41).

In the process, we have also identified and captured some of the core differences in the cultural context, focus of engagement approach, engager type and value creation across France, the Netherlands and UK in the following table. In general, interviewees see a bright future for engagement practices across all three countries, and expect a cross-national consolidation of these practices in future. However, some interviewees in France and the UK also mentioned the possible dangers of engagement being used to justify investment in securities that are financially strong yet problematic from an ESG viewpoint moving forward.

Differences across countries

France	Netherlands	United Kingdom
Culture		
▪ Questioning corporate executives not part of culture, in contrast to UK & Netherlands ▪ Traditional concerns with institutional 'activism' side of ESG engagement ▪ Large institutional investor interest in ESG engagement since 2010 onwards; assisted by "Article 173" of the 2015 Law on Energy Transition ▪ Growing institutional investor ESG knowledge & expertise enabling increased ESG engagement	▪ (ESG) engagement influenced by the Dutch Corporate Governance Code & Eumedion sustainability "guidelines" ▪ Strong influence of traditionally active NGO (RI) campaigns ▪ Growing sophistication of institutional investor ESG knowledge & expertise ▪ Second most dominant ESG engagement market in Europe	▪ Engagement anchored in tradition of "behind closed doors" dialogues & discussions with corporations pre-AGM ▪ (ESG) engagement influenced by UK Corporate Governance & Stewardship Codes ▪ Influence of traditionally active NGO (RI) campaigns ▪ Growing sophistication of institutional investor ESG knowledge & expertise ▪ Leading ESG engagement marketplace, with actors regarded as the most experienced engagers in all countries
Terminology		
▪ The term "engagement" has traditionally been associated with activist investor activities, & thus (ESG) "dialogues" as opposed to engagement is used most frequently	▪ Engagement has largely emerged from the notion & practice of "active ownership", & thus the terms are often used interchangeably; with a growing preference for "active ownership"	▪ Engagement is now considered a fundamental part of institutional investor stewardship activities, & there is growing preference for the use of the term "stewardship" over engagement
Focus of engagement		
▪ Emerging from & assisting (best-in-class) ESG integration efforts	▪ Highly thematic approach to ESG engagement	▪ More bottom-up focus & interest in relationship between engagement & ESG integration
Dominant types of engagers		
▪ Emergent ▪ Purposeful – Strategically Driven ▪ Compliant	▪ Purposeful – Culturally Driven ▪ Compliant ▪ Progressive	▪ Purposeful – Culturally Driven ▪ Compliant ▪ Progressive
Dominant value creation		
▪ Knowledge Value ▪ Collaborative Value ▪ Signalling Value ▪ Stewardship Value	▪ Financial Value ▪ Stewardship Value ▪ Knowledge Value ▪ Environmental & Social Value	▪ Financial Value ▪ Stewardship Value ▪ Relational Value ▪ Knowledge Value ▪ Collaborative Value

Source: Sustainalytics & Cass Business School

Need for institutional investors to improve the scope, content and quality of their (environmental and social) engagement disclosures

Our research has evidenced many interesting institutional investor insights into the current status of European environmental and social engagement, but it has also revealed a number of important issues that we feel need to be addressed going forward. The most obvious one is perhaps the need for institutional investors to improve the scope, content and quality of their (environmental and social) engagement

disclosures, so as to better inform all of their stakeholders about the complexity, challenges and benefits associated with their (integrated) engagement policies and approach. Here, there is also a role for RI/stewardship/active ownership/engagement standard setters and regulators to play, through the revision of existing reporting frameworks to facilitate more nuanced transparency and disclosure about engagement efforts, as opposed to the “tick-box” approach currently encouraged.

The role and influence of beneficiaries in engagement needs greater attention

Secondly, though not discussed in any detail in this report, the role and influence of beneficiaries in engagement needs greater attention. Many of our interviewees themselves, and in particular our asset owner interviewees, outlined that they need to do more to inform and educate their beneficiaries about their right to hold institutional investors to account for the responsible stewardship of their savings and investments. However, interviewees also outlined that beneficiaries in turn need to be interested and willing to participate in such educative processes.

Notion of environmental and social materiality of engagement is currently being neglected by institutional investors

More broadly, we would hope that our discussion of the impacts, outcomes and value association of engagement would also draw attention to the fact that the notion of *environmental and social materiality* of engagement is currently being neglected by institutional investors. This is perhaps due to the aforementioned challenges for institutional investors to actually pinpoint and record specific environmental and social impacts and “successes” of their engagements. Nevertheless, we feel that a shift in focus from trying to determine the financial materiality of engagement *only* to also considering the environmental and social materiality of engagements will be necessary, if frameworks to identify, record and where possible “measure” the broader environmental and social impacts of institutional investor activities are to be developed going forward.

ESG research providers may have a greater role to play in future

Here, we believe that ESG research providers may have a greater role to play in future, through the possible development, in consultation with institutional investor clients and/or their investee companies, of both quantitative and qualitative metrics to help monitor, record and disclose the environmental and social impacts of institutional investor engagement activities.

Overall typology of engagement & engagers

Types of Engagers	Policy	Engagement Process			Outcomes, Impact Types of Value Created & Accountability
		Triggering Process	Management & Execution	Monitoring, Evaluation & Recording	
Emergent Engagers	▪ Possibly no RI policy, or RI policy under development ▪ No engagement policy, or generic RI policy that provides a basic overview of engagement definition & approach	▪ Post ESG controversy (likely ESG research provider driven) ▪ Regulatory driven ▪ Market pressures ▪ Reactive	▪ One RI manager, very small or no ESG team responsible for engagement ▪ Little interaction between ESG & fund managers in planning & execution ▪ Objective & targets may not be set ▪ Engagements may take the form of emails/letters/phone calls only	▪ Less mature (structured/formalised) approach to monitoring, evaluating & recording company progress with engagements ▪ May not have database to assist ▪ Signalling value ▪ Prioritise accountability to clients	▪ Primary focus on financial value for clients ▪ Stewardship value ▪ Signalling value ▪ Prioritise accountability to clients
Compliant Engagers	▪ Standalone engagement policy, or generic RI policy that mentions engagement; may/may not specify strategy, definition & approach ▪ Materiality-focused engagement to satisfy clients	▪ Client pressures/influence ▪ Regulatory pressures ▪ Compliance with industry standards (via ESG research providers) ▪ Reactive	▪ Small to large ESG team; may/may not work with fund managers to plan &/or conduct engagement; limited ESG integration "loop" ▪ Objectives & targets normally set ▪ ESG engagements are often an "overlay" to regular company meetings with companies	▪ Mature (structured/formalised) approach to monitoring, evaluating & recording progress against engagement objectives & targets & final "success" ▪ Single engagement database to assist; may not feedback into main ESG database ▪ Potential knowledge value ▪ Accountability to clients; beneficiaries; regulators; standard setters (e.g. PRI)	▪ Primary focus on financial & stewardship value ▪ Potential knowledge value ▪ Accountability to clients; beneficiaries; regulators; standard setters (e.g. PRI)
Purposeful Engagers	▪ Standalone engagement policy, or, included in generic RI policy ▪ More likely to clarify strategy, definition & approach ▪ ESG issues/themes often specified to guide approach	▪ Internally driven &/or ESG controversies/performance driven (via ESG research providers) ▪ Primarily proactive	▪ Small, dedicated ESG team, working closely with fund managers to plan &/or conduct engagements ▪ Special ESG engagement dialogues beyond regular company contact/meetings	▪ May not have very mature approach to monitoring, evaluating & recording engagement progress & "success"; but natural ESG integration feedback loop	▪ Signalling value ▪ Financial value ▪ Prioritise/create other values based on culture & strategy
- Culturally Driven	▪ Emerging from values & principles ▪ Focus on fiduciary duty & environmental & social impacts	▪ Internal ESG standards & research ▪ Client &/or beneficiary preferences	▪ Objectives & targets not always set but clear ESG purpose for company dialogues ▪ "Integrated engagement" a natural process	▪ May/may not be a single engagement database; normally one main ESG database to assist & capture feedback	▪ Environmental & social value ▪ Stewardship & knowledge ▪ Accountability to all stakeholders
- Strategically Driven	▪ Emerging from ESG integration ▪ Focus on financial materiality	▪ Market movements & demands ▪ Internal ESG research driven	▪ Objectives & targets not always set but clear materiality orientated purpose for dialogues ▪ Strong ESG integration feedback loop	▪ Normally not a single engagement database, but one proprietary ESG integration database to record feedback	▪ Knowledge/collaborative value ▪ Relational value ▪ Accountability to clients; beneficiaries; regulators; standard setters ▪ Financial & stewardship value
Progressive Engagers	▪ Most sophisticated policy (not always standalone), clarifying engagement strategy; definition; approach; ESG themes; management; recording of outcomes/impacts ▪ Engagement considered core part of ESG integration practices ▪ Predominantly materiality focused to satisfy clients	▪ Strategically driven to reconcile ESG & financial performance at forefront of market ▪ Client/beneficiary preferences ▪ ESG controversy/performance (research provider influence), as well as internal ESG ▪ Both reactive & proactive	▪ Large ESG team working closely with fund managers to plan &/or conduct engagements; ESG integration & engagement feedback loop well established ▪ Specific engagement milestones, objectives, targets & timeframes set ▪ Beyond initial contact, strategic ESG dialogues conducted with companies (mainly with board/senior managers); often to also enhance/maintain long-term relationships	▪ Most mature approach to monitoring, evaluating & recording engagement progress; milestone achievement & "success"; incorporating regular internal "engager" quality checks, as well as team debates ▪ Sophisticated proprietary tools to assist & also feedback engagement data into main ESG integration database ▪ Client online portals to check progress	▪ Knowledge/collaborative value ▪ Signalling & relational value ▪ Potential for environmental & social value but not core focus ▪ Accountability to clients; beneficiaries; regulators; standard setters; & broader stakeholders

Source: Sustainability & Cass Business School

Appendix

Glossary of Terms

Our 2x2 typology of engagement and engagers incorporates the following definitions and conventions:

- **ESG integration:** We find the following definition a useful starting point: “ESG integration refers to the process of taking account of ESG data and information in investment research and decision-making processes. The definition is broad to take account of the different ways in which investment organisations consider ESG issues (such as screening, fundamental analysis, thematic analysis).”²⁴ In addition to this, we consider both the technological tools applied by institutional investors, such as (proprietary) databases, *as well as* the relational and operational systems adopted between ESG and fund managers within institutional investors, as important components of ESG integration efforts.
- **Engagement maturity:** We consider engagement maturity as the degree to which institutional investor engagement processes are structured and formalised.
- **Engagement process:** We consider an engagement process as encompassing everything relating to the following engagement dimensions/practices: policy; triggers; execution and management; monitoring, evaluating and recording; impact, outcome and accountability of engagements.
- **Structured engagement process:** We consider a structured engagement process as that which has a clearly defined objective, approach and organised operational systems – often supported via a database or databases – for the above engagement dimensions/practices.
- **Formalised engagement process:** We consider a formalised engagement process as that which has “formalised” – through internal/external policy, guidelines and/or audit/reporting/accountability channels – a structured approach to each of the above engagement practices.

Methodology

Motivation

Our research aimed to explore the organisational processes that underlie investors’ individual, as opposed to collaborative, responsible engagement strategies in order to unlock the “black box” of ESG engagement practices. We were particularly interested in investigating environmental and social (E&S) engagements, as opposed to governance, as the latter has received most attention to date. We also chose to focus on E&S dialogues between institutional investors and investee companies, as opposed to investor voting strategies and activities, which have also tended to receive slightly more attention to date.

Prior research has predominantly taken a quantitative approach to the analysis of (governance-related) engagements. However, in order to address our specific research objective to gain a deeper understand of institutional investor engagement processes, we adopted a qualitative research approach. This approach was also the most appropriate, given the exploratory nature of our research into a relatively new phenomenon in institutional investment.

Approach

We conducted 36 interviews with institutional investor clients and stakeholders of Sustainalytics in France (12), Netherlands (12), and the UK (12). To gain a better understanding of the engagement “value chain”, we interviewed 27 asset managers, including two asset managers who are also engagement service providers, as well as 9 asset owners (including one external asset owner expert).

List of participant organisations

Type of organizations	Countries			Total number
	France	Netherlands	United Kingdom	
Asset Owners	ERAFP (<i>Établissement de Retraite Additionnelle de la Fonction Publique</i>)	Achmea	Anonymous expert	
		Univest	The Pensions Trust	
	FRR (<i>Fond de Reserve pour les Retraites</i>)	Zwitserleven	USS	
	Ircantec			
	3	3	3	9 (25%)
Asset Managers	AGICAM	ABN AMRO	Aviva	
	Amundi	ACTIAM	Anonymous	
	AXA IM	APG	EdenTree	
	BNP Paribas IP	ASN	Fidelity International	
	ECOFI Investissements	NN Investment Partners	First State Investments [AUS]*	
	Federal Finance	TKP Investments	Jupiter Asset Management	
	HSBC Global AM [UK]*	PGGM	Anonymous	
	Mirova	Triodos Investment Management	Standard Life Investments	
	Sycomore			
	9	8	8	25 (69%)
Asset Manager & Engagement Service Provider		RobecoSAM	Hermes EOS	
	0	1	1	2 (6%)
Total number	12 (33%)	12 (33%)	12 (33%)	36

* Classified according to the country that was the focus of ESG operations for the interview

Source: Sustainalytics & Cass Business School

The table above provides the list of the organisations that participated in this research; however, the names of individual interviewees have not been disclosed, as per our confidentiality agreements. These practitioners were either the Head of, or members of, relevant ES(G) or responsible investment (RI) teams that were responsible for (managing) ESG engagements in interviewee organisations.

All interviews were conducted in person, apart from two telephone interviews conducted due to geographical and time constraints, and took on average one hour. Each interview was semi-structured, meaning that it was sufficiently structured to collect information on key pre-defined topics, while also sufficiently flexible to allow for new or unexpected ideas or topics to emerge through the interview conversations. All interviews were recorded and transcribed, following interviewee consent, for analysis purposes.

To help us understand interviewee engagement activities further, we complemented our analysis with the collection of secondary data consisting of publicly available information from interviewee organisations related to their RI and ESG engagement policies and activities, such as their RI, engagement and PRI reports. This data was collected and analysed before the interviews were conducted in order to get a better sense of the interviewees' engagement experience and context. Some organisations also provided us with their (draft) policy or unpublished data after the interview. All of the secondary data was organised in a database, along with all interviewee audio files and transcripts, to be retrieved easily.

Interview questions

Our interview questions were structured around five key topics:

- (1)** the interviewee's background and the organisation's approach to engagement, the latter incorporating the: definition of engagement; presence of a formal engagement policy; philosophy of engagement, etc.;
- (2)** the internal engagement strategy, method and impact, incorporating, for example, questions on: how engagement is related to other RI strategies; who is responsible for engagement; how engagement is triggered; how engagement objectives are defined; how engagement is conducted, monitored and managed; how the outcomes of engagement are tracked and recorded; how an engagement "success" is determined and recorded; what the internal barriers/enablers to the development of ESG engagement are;
- (3)** the influence of, and relationship with, external actors throughout engagement processes, with a particular focus on the role of ESG research providers, for example, Sustainalytics, and/or additional organisations such as the PRI initiative;
- (4)** the accountability of engagement processes, incorporating: the relationship between asset owners and managers, as well as institutional investors and beneficiaries, standard setters and NGOs; and the nature of institutional investor engagement disclosures; and
- (5)** issues surrounding the future of engagement.

Interview analysis

All transcribed interviews, as well as interviewee secondary data, were analysed by the two researchers with the assistance of analytical research “codes” developed in relation to the five main interview question categories outlined above. Through our analysis of the interviews against these research codes, we could identify interesting differences and commonalities between the interviewee approaches to engagement across the three countries. To make sense of these differences, in the **first stage of analysis**, we developed a “raw” framework describing the key steps of engagement processes that we refined and simplified as our analysis progressed. This included the following components of engagement processes: “formal policy”; “triggering process”; “management & execution”; “monitoring, evaluation & recording”; and “outcomes, impacts and accountability”.

We systematically compared our data across organisations along these five dimensions and identified important commonalities and differences across organisations and countries that we presented in our findings. Another emerging finding of this first level of analysis pointed to important differences in how engagement was valued by each organisation. We listed all the values associated with engagement by the organisation, and in phase two of our analysis, we classified them inductively into a coherent set of seven values, namely: **financial; stewardship; knowledge; collaborative; signalling; relational; and environmental and social**.

During the **second stage of analysis**, we analysed our data to identify differences that explain variances in the styles of ESG engagement adopted by each organisation. We found that the level of ESG integration as well as the maturity of ESG engagement (structuration and formalisation of the engagement process) in each organisation were the two key elements capturing the most important variance across interviewee modes of engagement. We then re-analysed our organisations along these two dimensions, and identified the four types of engagers that are presented in our report, namely: **emergent, compliant, purposeful and progressive engagers**. We also found that two sub-types of purposeful engagers could also be identified: culturally driven engagers and strategically driven engagers.

During the **third and final stage of analysis**, we re-analysed the different steps of the engagement process, in light of our typology of engagers, to determine which types of engagers can produce and benefit from the seven values of engagement. This report provides a synthesis of the main results of these three stages of analysis.

Endnotes

- 1 For further details, see for example:

 Bauer, R., Clark, G. and Viehs, M. (2013), "The Geography of Shareholder Engagement: Evidence from a Large British Asset Manager", ECCE Working Paper: Maastricht University and Oxford University, available (06.06.2016) at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2261649

 Blackrock and Ceres (2015), "21st Century Engagement: Investor Strategies for Incorporating ESG Considerations into Corporate Interactions", available (06.06.2016) at: <https://www.blackrock.com/corporate/en-us/literature/publication/blk-ceres-engagementguide2015.pdf>

 ECCE and KCM (2013), "Shareholder Engagement: An Alternative Way to Invest Responsibly", available (06.06.2016) at: http://www.kempen.nl/uploadedFiles/Kempen/01_Asset_Management/Producten_en_diensten/VerantwoordBeleggen/Research%20paper%20ECCCE.pdf

 EuroSIF (2013), "Shareholder Stewardship: European ESG Engagement Practices 2013", available (06.06.2016) at: <http://www.eurosif.org/publication/shareholder-stewardship-european-esg-engagement-practices-2013/>

 Gond, P. and Piani, V. (2013), "Enabling Institutional Investors' Collective Action: The Role of the Principles for Responsible Investment Initiative", Business & Society Vol. 52 No.1, pp. 64–104

 VBDO (2014), "Engagement: Box-ticking or Catalyzing Sustainability", available (06.06.2016) at: http://www.vbdo.nl/files/media/VBDO_Goed_Engagement_Def_2.pdf
- 2 EuroSIF SRI Survey (2014), available (06.06.2016) at: <http://www.eurosif.org/wp-content/uploads/2014/09/Eurosif-SRI-Study-20142.pdf>
- 3 FNG (2016), Marktbericht Nachhaltige Geldanlagen 2015, available at: <http://www.forum-ng.org/de/fng/aktivitaeten/752-marktbericht-nachhaltige-geldanlagen-2015-deutschland-oesterreich-und-die-schweiz.html>
- 4 For examples, see Clark, G., McGill, S., Saito, Y. and Viehs, M. (2015), "Institutional Shareholder Engagement with Japanese firms", Annals in Social Responsibility, Vol. 1 No. 1, pp. 30–56, and Dimson, E., Karakas, O. and Li, X. (2015), "Active Ownership", The Review of Financial Studies, Vol. 28 No. 12, pp. 3225-3268
- 5 EuroSIF SRI Survey (2014), op. cit.
- 6 For more details see: <https://www.unpri.org/report>
- 7 For more details see: <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx>
- 8 For more details see: <http://eumedion.nl/en/abouteumedion>
- 9 For more details see: <http://www.plsa.co.uk/PolicyandResearch/Corporate-Governance/Stewardship/Stewardship-disclosure-framework.aspx>
- 10 Article 173-VI of Law 2015-992. For further information on the law (in French) see: https://www.legifrance.gouv.fr/eli/loi/2015/8/17/2015-992/jo/article_173. For an overview in English see: <http://www.lse.ac.uk/GranthamInstitute/law/law-n-2015-992-on-energy-transition-for-green-growth-energy-transition-law/>
- 11 Relevant indicators include: LEA 01 Description of approach to engagement; LEA 09 Share insights from engagements with internal/external managers; LEA 12 Engagements on E, S and/or G issues; LEA 13 Companies changing practices/behaviour following engagement; and LEA 14 Examples of ESG engagements.
- 12 For further information about the other requirements of the Directive, see: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P8-TA-2015-0257+0+DOC+XML+V0//EN>
- 13 Conducted between November 2015 and May 2016. Please see the Appendix for more details of our methodological approach.

- ¹⁴ This respondent was between appointments at two different UK asset owners at the time of the interview, and therefore does not wish her views to be affiliated with either organisation.
- ¹⁵ EuroSIF SRI Survey (2014), op. cit.
- ¹⁶ For further information on the law (in French), see: https://www.legifrance.gouv.fr/eli/loi/2015/8/17/2015-992/jo/article_173. For an overview in English, see: <http://www.lse.ac.uk/GranthamInstitute/law/law-n-2015-992-on-energy-transition-for-green-growth-energy-transition-law/>
- ¹⁷ The Investment Management Association (2015), Adherence to the FRC's Stewardship Code, available (06.06.2016) at: <http://www.theinvestmentassociation.org/assets/files/surveys/20150526-fullstewardshipcode.pdf>
- ¹⁸ Though this reflects the fact that we spoke to more active than passive managers, it also reflects broader industry trends. None of our interviewees are currently involved in fixed income engagements regarding sovereign bonds.
- ¹⁹ EuroSIF SRI Survey (2014), op. cit.
- ²⁰ When we refer to ESG throughout the Findings section, we are primarily interested in environmental and social, as opposed to governance, issues (and/or incorporating governance implicitly).
- ²¹ PRI Reporting Framework Listed Equity Active Ownership (LEA) indicator 13.1 is a voluntary indicator that requires signatories to: "Indicate whether you have a reliable estimate of the number of cases during the reporting year where a company has changed its practices, or made a commitment to do so, following your organisation's and/or your service provider's engagement activities." Voluntary indicator LEA 13.2 requires signatories to: "Indicate the number of companies that changed or committed to change in the reporting year following your organisation's and/or your service provider's engagement activities."
- ²² For example, Dimson et al. (2015) claim that successful private engagement leads to an average annual alpha of 7.1% subsequent to successful engagement. See: Dimson, E., Karakas, O. and Li, X. (2015), "Active Ownership", *The Review of Financial Studies*, Vol. 28 No 12, pp. 3225-3268
- ²³ UNEP, UNGC, UN PRI, UNEP Inquiry (2015), "Fiduciary Duty in the 21st Century", available (06.06.2016) at: http://www.unepfi.org/fileadmin/documents/fiduciary_duty_21st_century.pdf

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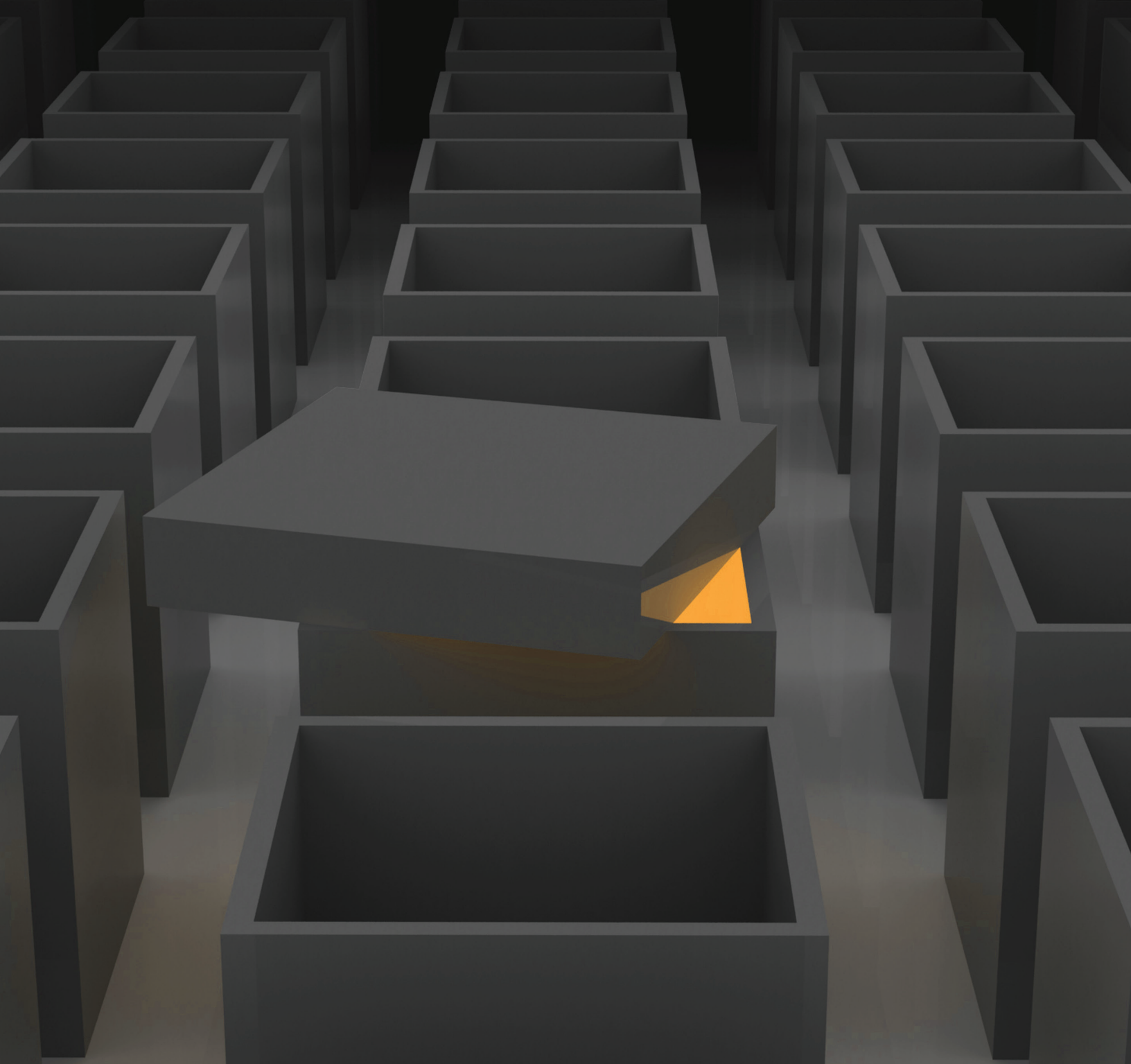
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