# ACTIVE OWNERSHIP BEST PRACTICES GUIDE

## Asset Class: Equities

NAWAR ALSAADI, FSA, SIPC

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# Section 0: What is Active Ownership?

## 1. Active Ownership

Active ownership, or engagement, entails an active and purposeful dialogue between an investor and an investee company for the purpose of improving the activities or behaviors of the company, specifically as it relates to its corporate strategy or its sustainability (ESG) performance. The ultimate goal of such dialogue is to enhance and preserve the value of the investors' investment.

Increasingly, regulators, clients, and beneficiaries are demanding that asset managers and asset owners engage with their portfolio companies to maintain and enhance the value of their assets. The 2020 UK Stewardship Code[1] (Principle 9) explicitly demands that signatories actively engage with investee companies on the basis of a viable engagement plan and that they provide timely reports on the outcome of these engagements. The EU Shareholder Directive II demands, among other things, that asset managers and asset owners develop and implement a transparent engagement policy (Article -17[2]):

'Institutional investors and asset managers should therefore be more transparent as regards their approach to shareholder engagement. They should either develop and publicly disclose a policy on shareholder engagement or explain why they have chosen not to do so. The policy on shareholder engagement should describe how institutional investors and asset managers integrate shareholder engagement in their investment strategy, which different engagement activities they choose to carry out, and how they do so. The engagement policy should also include policies to manage actual or potential conflicts of interests, in particular situations in which the institutional investors or asset managers or their affiliated undertakings have significant business relationships with the investee company. The engagement policy or the explanation should be publicly available online.'

Similar such recommendations and requirements have emerged in many other jurisdictions such as South Africa, Japan, South Korea, Hong Kong, and Singapore, among others. In 2017, a coalition of US-based investors launched a Framework for US Stewardship and Governance.[3] In Canada, the Canadian Coalition for Good Governance has maintained a set of principles on shareholder engagement since 2005. Globally, the International Corporate Governance Network has enshrined engagement in its Stewardship Principals since 2016.[4]

### Does Engagement Really Enhance Shareholder Value?

Several empirical studies have demonstrated a causal relationship between active ownership/engagement and improved accounting and market outcomes. An extensive 2015 active ownership study[5] of over 2000 ESG engagements during a 10-year period concluded the following:

'We find that ESG engagements generate a cumulative size-adjusted abnormal return of +2.3% over the year following the initial engagement. Cumulative abnormal returns are much higher for successful engagements (+7.1%) and gradually flatten out after a year, when the objective is accomplished for the median firm in our sample. We do not find any market reaction to unsuccessful engagements.'

A 2019 meta-study[6] of investor engagement impact literature was categorical in its conclusion as to the value of engagement in generating real-world sustainability outcomes:

**'Shareholder engagement emerges as the most reliable mechanism for investors seeking impact, in the sense that it has been clearly demonstrated empirically.'**

1 https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf
2 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017L0828
3 https://www.arx.cfa/-/media/regional/arx/post-pdf/2020/08/10/stewardship-20-in-asia-pacific.ashx?la=en&hash=67F9A610A6BA3968BEB68DD46869708965BCA63F
4 https://www.icgn.org/sites/default/files/ICGNGlobalStewardshipPrinciples.pdf
5 Dimson, Elroy and Karakaş, Oğuzhan and Li, Xi, Active Ownership (August 7, 2015). Review of Financial Studies (RFS), Volume 28, Issue 12, pp. 3225-3268, 2015., Fox School of Business Research Paper No. 16-009, Available at SSRN: https://ssrn.com/abstract=2154724 or http://dx.doi.org/10.2139/ssrn.2154724
6 Kölbel, Julian and Heeb, Florian and Paetzold, Falko and Busch, Timo, Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact (July 20, 2019). Kölbel, Julian F., Florian Heeb, Falko Paetzold, and Timo Busch. in press. 'Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact'. Organization & Environment. Available at: https://doi.org/10.1177/1086026620919202 , Available at SSRN: https://ssrn.com/abstract=3289544 or http://dx.doi.org/10.2139/ssrn.3289544

The purpose of this guide is not to demonstrate the value of engagement per se, rather to guide you through the engagement process itself. (For those interested in learning more about the empirical evidence in support of engagement, the Social Science Research Network provides a wealth of information on the topic: https://www.ssrn.com/index.cfm/en/)

## 2. Where Does Active Ownership Fit in The Responsible Investing Universe?

The Global Sustainable Investment Alliance[7] (GSIA) classifies responsible investing under the following seven categories:

- **Negative/exclusionary screening:** the exclusion from a fund or portfolio of certain sectors, companies, or practices based on specific ESG criteria.
- **Positive/best-in-class screening:** investment in sectors, companies, or projects selected from a defined universe for positive ESG performance relative to industry peers.
- **Norms-based screening:** screening of investments against minimum standards of business practice based on international norms and standards such as those issued by OECD, ILO, UN, and UNICEF; may include exclusions of investments that are not in compliance with norms or standards or over and underweighting.
- **ESG integration:** the systematic and explicit inclusion by investment managers of environmental, social, and governance factors into the investment decision-making process.
- **Sustainability-themed investing:** investment in themes or assets specifically related to sustainability (for example, clean energy, green technology, or sustainable agriculture).
- **Impact/community investing:** targeted investments, typically made in private markets, aimed at solving social or environmental problems, and including community investing, where capital is specifically directed to traditionally underserved individuals or communities, as well as financing that is provided to businesses with a clear social or environmental purpose.
- **Corporate engagement and shareholder action:** employing shareholder power to influence corporate behaviour, including through direct corporate engagement (i.e., communicating with senior management and/or boards of companies), filing or co-filing shareholder proposals, and proxy voting that is guided by comprehensive ESG guidelines.

Responsible investing classifications and definitions may differ across industry practitioners. Some consider engagement an integral part of their ESG integration strategy rather than a standalone approach, as highlighted by GSIA. Others may use engagement as an impact investing tool by explicitly targeting sustainability/ESG laggards within their portfolios.

The engagement steps outlined in the following guide apply to the lion's share of engagements regardless of where you choose to classify them within your responsible approach.

7 http://www.gsi-alliance.org/wp-content/uploads/2017/03/GSIR_Review2016.F.pdf

# Section 1: Goal, Objective, and Metrics

## 1. Set Broad Engagement Goal(s)

Before engaging with companies on their sustainability or business performance, you would need to establish a clear overarching goal as to why you are engaging with them. Establishing a goal is easier said than done. To establish an engagement goal, you need to develop a deep understanding of your investing and sustainability/ESG priorities. These sustainability/ESG priorities entail a value judgment in certain instances, thus the need to establish an internal value system prior to engaging with companies. It is imperative to understand how engagement fits both within investment strategy and within organizational sustainability/ESG priorities. Below are some of the key goals as to why investors usually engage with their investee companies:

a. Enhance portfolio investment returns.
b. Enhance sustainability/ESG performance.
c. Reduce financial risks.
d. Reduce sustainability/ESG risks.
e. Comply with Sustainability/ESG regulation.
f. Comply with ESG investment mandate.
g. Advance specific sustainability such as the UN Sustainable Development Goals, the Paris Accord, UN Global Compact, or FAIRR, among others.
h. Information gathering.

The above applies both to individual investments and/or to the totality of the portfolio. You may combine multiple goals as part of your engagement goal-setting process.

## 2. Set Specific Engagement Objective

- Your engagement objective is a function of your engagement goal. For example, if your engagement goal is to advance UN-SDG-6 (Clean Water & Sanitation), your objective would be to improve the target company, or a portfolio of companies' water management practices.
- Be careful not to set too many specific objectives for a single engagement. While it is fine to discuss a number of business and sustainability issues with the target company (or companies) during any given communication, it is vital that to have clarity on prioritized engagement area, or areas, beforehand.

## 3. Select Engagement Target & Metrics for Engagement

Selecting an engagement target is a function of point 1 (Broad Engagement Goal(s)) and point 2 (Engagement Objective(s)). To select an engagement target from your portfolio, or your available investment universe, you need track, evaluate, and compare the relevant sustainability/financial metrics to each set objective.

**Metrics:**

a) For (1.a) Enhance investment returns and (1.c) Reduce financial risks:

- Focus on financial metrics both in the absolute and in comparison with the sector (return on capital, return on assets, profit margin, revenue growth, equity performance, balance sheet strength, capital structure, valuation, and trading multiples, and corporate strategy, among other relevant financial indicators).

7 http://www.gsi-alliance.org/wp-content/uploads/2017/03/GSIR_Review2016.F.pdf

- Focus on financially material sustainability metrics as defined by SASB for sector and industry classification (https://www.sasb.org/find-your-industry/) and (https://www.sasb.org/standards/materiality-map/) - (check example at the bottom of the section). You may use alternative ESG data sets if you desire, however, make sure that the underlying ESG data is financially material and sector relevant.

**b**) For (1.b) Enhance sustainability/ESG performance, and (1.d) Reduce sustainability/ESG risks:

- Focus on the full spectrum of sustainability metrics and indicators as defined by SASB, GRI (https://www.globalreporting.org/) and TCFD (https://www.fsb-tcfd.org/) in particular. You can also use ESG assessment services such as Sustainalytics or MSCI, however make sure that you understand the rating methodology and its associated indicators.

**c**) For (1.e) Comply with sustainability/ESG regulation and (1.f) Comply with investment mandate:

- Engage on the regulatory and mandate specifics as outlined by the law or investment mandate, make sure to document and report on these activities to the relevant regulators and clients.
- Regardless of regulation, following your jurisdiction stewardship code recommendations is always good practice and it may prepare you for future engagement-related legislation.

**d**) For (1.g) - Advance a specific sustainability agenda:

- Focus on the relevant sustainability metrics associated with that agenda. In case of a lack of relevant metrics to address your desired sustainability agenda, develop a set of relevant metrics from an existing framework, or build a custom-made framework to track and measure your target sustainability area of interest. Tools such as SDG Compass could be valuable when converting topics such as the Sustainable Development Goals into business metrics: https://sdgcompass.org/

**e**) For (1.h) Information gathering engagements:

- Make sure to focus your questions on the area/areas of interest and address them to the right officer/officers within the target firm. Information gathering engagements can assist you in developing metrics for the aforementioned engagement areas.

Depending on your ESG integration strategy, some of the aforementioned metrics might already be tracked closely by your firm. However, if you are not tracking these metrics closely, make sure to select a data provider, or hire experts, with sufficient knowledge or focus on the metrics of relevance to you.

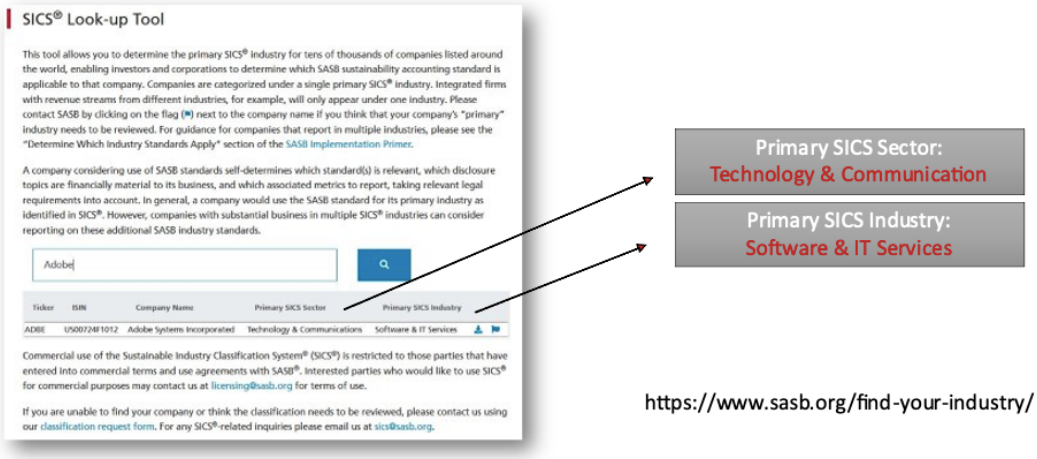
**Important: Prioritize Your Metrics**
Should your goal/objective engagement area be associated with multiple metrics, make sure to prioritize metrics by order of importance or impact. Engaging on too many metrics risks diluting your final objective and may complicate the engagement process.

7 http://www.gsi-alliance.org/wp-content/uploads/2017/03/GSIR_Review2016.F.pdf

**Example:** Finding financially material social sustainability metrics for Adobe Inc (using SASB):

## Step 1

Find Adobe's SASB SICS classification through SASB's SICS Look-up Tool




https://www.sasb.org/find-your-industry/

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*Figure 1.0*

## Step 2

Locate the material sustainability factors for Technology & Communication/Software & IT Services at the Social Capital section of SASB's Materiality Map


Material Social Capital Sustainability issues for Technology & Communication/Software & IT Services: **Customer Privacy** and **Data Security**.

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https://materiality.sasb.org/ 6

*Figure 2.0*

7 http://www.gsi-alliance.org/wp-content/uploads/2017/03/GSIR_Review2016.F.pdf

## Step 3

From SASB's Materiality Map Extract the relevant indicators for the identified material social capital sustainability factors at Adobe's sector and industry.

| | | | | |
|---|---|---|---|---|
| Data Privacy & Freedom of Expression | Discussion of policies and practices relating to collection, usage, and retention of customers' information and personally identifiable information | Discussion and Analysis | n/a | TC0102-04 |
| | Percentage of users whose customer information is collected for secondary purpose, percentage who have opted-in | Quantitative | Percentage (%) | TC0102-05 |
| | Amount of legal and regulatory fines and settlements associated with customer privacy[III] | Quantitative | U.S. dollars ($) | TC0102-06 |
| | Number of government or law enforcement requests for customer information, percentage resulting in disclosure | Quantitative | Number, Percentage (%) | TC0102-07 |
| | List of countries where core products or services are subject to government-required monitoring, blocking, content filtering, or censoring[III] | Discussion and Analysis | n/a | TC0102-08 |
| Data Security | Number of data security breaches and percentage involving customers' personally identifiable information[IV] | Quantitative | Number, Percentage (%) | TC0102-09 |
| | Discussion of management approach to identifying and addressing data security risks | Discussion and Analysis | n/a | TC0102-10 |

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*Figure 3.0*

**Screening for Engagement Targets**
Identifying the relevant metrics to track/measure will help you screen for the companies that fit your engagement criteria. The screening can be done through a commercial ESG data solution or could be developed in-house. However, just like engagement metrics, engagement targets should also be prioritized. While it is possible to mass engage with multiple companies at the same time through collective letters, or shareholder proposals, you shouldn't stretch yourself too thin. Your engagement target list will ultimately be a function of the scale of the business or sustainability issue at a given company or companies, the issue potential impact on your portfolio, your ability to affect change, the availability of engagement metrics, your engagement resources, and the nature and urgency of your engagement goal. At any given time, you should maintain a 'focus list' of engagement targets that fits your engagement priority areas.

# Section 2: Engagement Process

## 1. Engagement Plan

a. Define Engagement Scope
b. Set KPIs & Milestones, and Timelines
c. Select Engagement Approach
d. Select Communication Method
e. Establish Escalation Strategy


*Figure 4.0*

**a) Define Engagement Scope**
The engagement scope is a function of the following variables:

| | |
|---|---|
| • The objective of your engagement;<br>• The urgency of the engagement;<br>• The nature of the business or sustainability deficiency exhibited by the company;<br>• Available engagement resources (material and human);<br>• The size of your investment in the company (as a percentage of your portfolio and as an ownership position in the company);<br>• Investment holding period;<br>• Stewardship policy (if you have one);<br>• The extent of change you would like to see at the company; | • Whether you are engaging on a single sustainability or business issue, or multiple issues at once;<br>• The regulation or investment mandate because of which you are engaging;<br>• The extent of buy-in inside your firm (it is vital that your engagement has the backing of the relevant teams, departments, and officers within your organization);<br>• The strength of your theory of change for the chosen engagement topic. |

*Table 1.0*

- When outlining engagement scope, be aware of the inverse relationship between the complexity of the ask and the time required to see it through. Asking a coal miner to become a renewable energy company is far more complex than asking a coal miner to disclose its scope 1 emissions. (Figure 5.0)

- When addressing multiple sustainability deficiencies at a given company, make sure to align the engagement scope with your sustainability deficiency priorities (priority areas set the tone of the engagement scope).

- The engagement scope will have a direct impact on your escalation strategy, it is at this stage that you should decide whether you would be open to an aggressive escalation strategy, pursue a form of 'quiet diplomacy', or limit your interaction to a nimble exchange.

- The engagement scope is not static, the scope may change and evolve overtime as new information comes into light, nonetheless you should be aware of your engagement scope at all times, and make sure that it remains consistent with the exigencies of the variables highlighted in table 1.0.

**Example:** Engagement Scope Scale


*Figure 5.0*

Your organization should set up an engagement scope scale, categorizing engagements per length of time, complexity, logistics, human resources, skillset, among other criteria. For example, a limited scope engagement may involve a single letter or a phone call to a relatively low-level officer at a given company focusing on a relatively minor issue, such as disclosing a simple sustainability metric. On the other side of the spectrum, an extensive engagement may last for several years, involve multiple engagers, require multiple letters, meetings, and material escalation.

Establishing scope will guide establishing a reasonable engagement timeline, inform escalation strategy, determine whether to form a coalition with fellow shareholders (should a collective engagement be a viable approach), establish milestones, inform target setting for the evaluation metrics, and indicate the human, material, and time resources needed for the engagement. The scope setting stage will also highlight any gaps you might have in your sustainability or business case for a given engagement and will provide you with an opportunity to address them.

When establishing an engagement scope, you will need to consult closely with the relevant departments within your firm. In case of an ESG engagement, you will need to understand the investment case from a financial perspective and structure your engagement in full alignment with the portfolio manager (or portfolio managers if you hold the security in multiple funds) investment strategy. You need to co-ordinate with the proxy manager and ensure that your engagement approach is consistent with the firm voting policy. If your firm has an integrated ESG investing strategy where portfolio managers handle engagements, some of these steps might not be necessary, but if your firm has a dedicated stewardship and engagement department, close co-ordination with the relevant departments is vital. There are pluses and minuses to having a separate or integrated engagement function; a portfolio manager might not have the skill, time, or focus necessary to engage on ESG topics, thus a dedicated ESG engagement function may be needed.

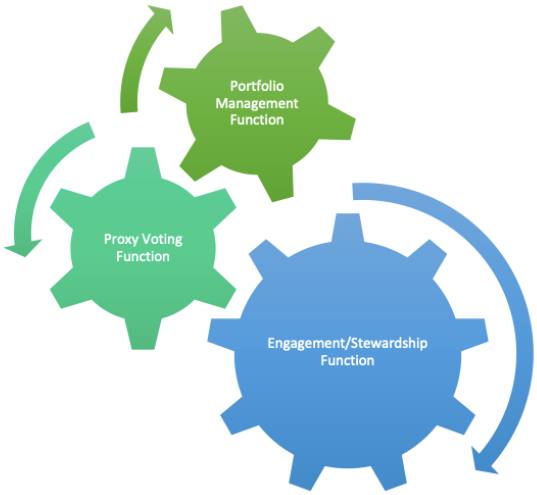



*Figure 6.0 – Internal co-ordination for scope setting.*

**b) Set KPIs & Milestones, and Timelines**

**Timeline**
Your engagement timeline is a function of the complexity of the identified business and/or sustainability deficiency and its urgency. Your engagement timeline is also a function of your investment horizon and/or available engagement resources.


*Figure 7.0 – Outlines a few examples of requests and how they map from a complexity and engagement timeline standpoint.*

**Milestones**
Milestones are set along the engagement timeline, they guide whether you are moving at pace with your projected timeframe. Missed milestones might signal a need for a change of engagement approach or a need to escalate.


*Figure 8.0*

Milestones act as 'mini objectives' within your broader engagement objective(s). Milestones can remain internal to your firm or be shared with the target company for tactical or strategic reasons. Milestones can also be extended, changed, or canceled depending on the progress of your engagement. It is important that you keep taps on your milestones, keep them relevant, updated, timely, and reflect where you are in the process.

**Key Performance Indicators (KPIs)**
Key Performance Indicators (KPIs) are the indicators you use to gauge a company's performance in relation to your chosen engagement area. These indicators/metrics should have been identified in Section 1 ( What Metrics to Engage on). At this stage of the process, you should set the desired targets for each identified indicator. To do so, we will continue with the same Adobe Inc. example from Section 1:

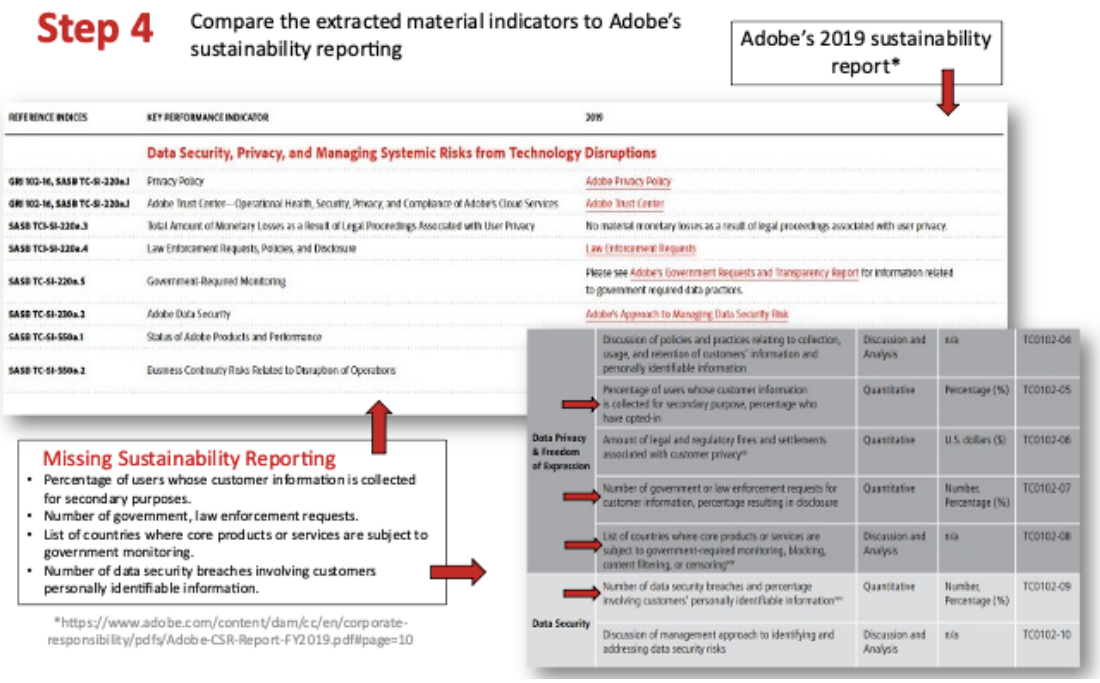



*Figure 9.0*

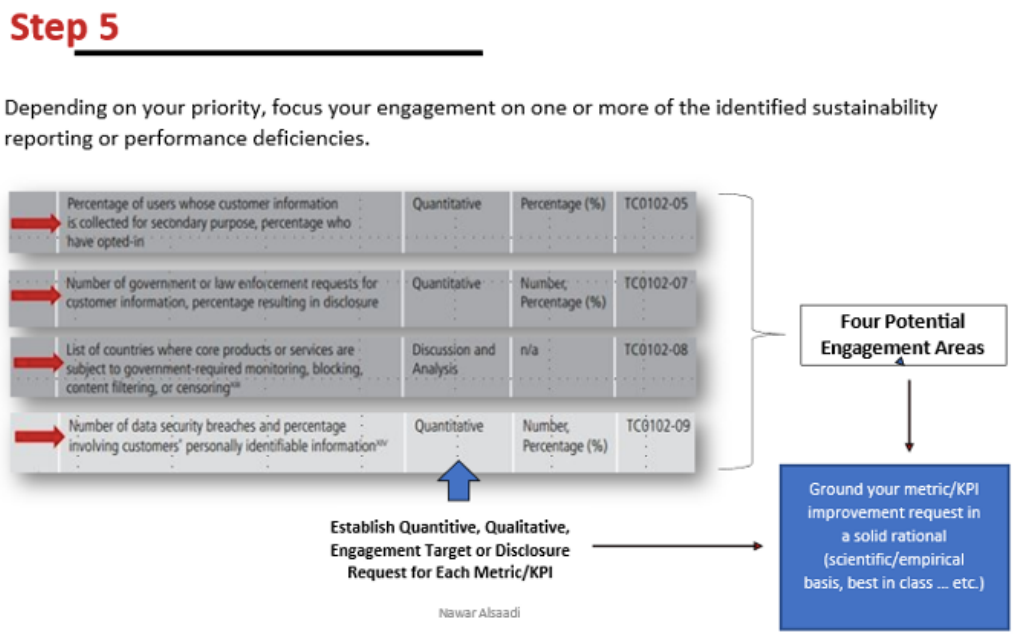



*Figure 10.0*

Once you have identified the performance targets for your selected metrics, communicate these metrics and associated targets to the engaged company. Explain targets' rationale and by when the company is expected to meet these targets. If you have identified a path/solution with which the company can achieve these targets, you may share it with the company.

**c) Select Engagement Approach**

Your chosen engagement approach is a function of the engagement final objective, the scope and complexity of the business/sustainability request, the desired/available timeline, the urgency of the sustainability matter, the culture and prevailing regulatory environment, and you (the engager) available resources.

- **Short vs. Long Term:** A long-term engagement approach is proper for a fundamental long-term sustainability improvement (such as profound corporate strategy change at the investee company). Conversely, a short-term engagement approach is appropriate for a simple sustainability improvement (such as improving the investee company sustainability disclosure). Clarity on the engagement scope (1.a) will inform the duration of the engagement. Keep in mind that successful engagements can take as long as three years in certain cases, make sure your engagement approach is designed for the long haul.

- **Individual vs. Collective:** In general, individual engagements are best suited for an initial engagement as they are the least threatening to the target company and easier to execute, although, in certain circumstances, a collective engagement might be appropriate as an initial approach (such as when previous individual engagements have failed). An individual engagement can evolve into a collective one as part of an escalation strategy. Note that if fellow shareholders are already engaging with the target company on the same subject joining forces with them might be the best course of action to avoid duplication of efforts and facilitate a positive engagement outcome. Collective engagements tend to have a bigger impact, however, collective engagements are much harder to organize/manage than individual engagements. Accordingly, one should be aware of the trade-off between impact and efficiency when deciding on an individual or collective engagement approach. 'Acting in concert' regulation in certain jurisdictions can further complicate a collective engagement approach. Collective engagement entities such as those listed below facilitate a collaborative engagement approach. Finally, readiness to be part of a collective engagement will equally be informed by your engagement scope. Potential venues for collaborative engagements:

  - Council of Institutional Investor
  - Ceres' Investor Network on Climate Risk
  - Principles for Responsible Investment
  - 30% Coalition
  - Center for Public Accountability
  - Interfaith Center on Corporate Responsibility
  - International Corporate Governance Network
  - CDP
  - Investors Forum
  - Share.ca

***Warning:*** *Don't fall into the trap of avoiding collective engagements to keep the credit for yourself. What matters is the engagement outcome, not the credit.*

- **Private vs. Public:** private engagements are generally perceived to be less hostile than public engagements. Public engagements are often the product of a failed private engagement. In certain cultures, where saving face is important, such in Asia and the Middle East, it is best to focus on a private approach.

- **Meeting with Company:** Meeting company officials in person or individually is best taken as a second step after an initial written letter outlining the issues at hand has been submitted. Nonetheless, a courtesy call to investor relations or the corporate sectary of an upcoming letter might be a tactful step to take. In an extreme or urgent situation, a meeting could be initiated without a prior engagement ask letter.

- **Officer to Engage:** which officer to engage at a given company is a function of the sustainability or business factor subject to engagement. The Chairman or Lead Director is usually the right person to approach a governance-focused engagement, while the Head of the Sustainability Committee or Chief Sustainability Officer is likely the best officer to approach when discussing a specific sustainability performance metric. You do not necessarily need to commence an engagement from the top. An engagement can start at a relatively low level, such as with the IR manager, especially if the matter is not urgent or highly material.

- **Informal Engagement Approach:** An individual or a collective engagement meeting may commence informally, as a side discussion during an annual shareholders' meeting, investors' meeting, or other formal/informal event. An investor may choose an informal engagement approach by design.

- **Timing:** When engaging a company, you need to be cognizant of its regulatory deadlines, such as the annual shareholder meeting (AGM). Periods leading to the AGM tend to occupy much of a given company officer's time and may not be conducive for a large scope engagement. Periods immediately following the AGM or quiet periods prior to quarterly earning could provide a window for a long-term strategy or sustainability discussion.

- **Intensity:** The intensity of your engagement approach will be decided during this phase (in alignment with your engagement scope). The intensity of your engagement could have beneficial or adverse effects on your engagement outcome and must be given sufficient thought. Urgent matters will likely require an intense/aggressive approach, meanwhile, long-term strategic engagements might require a more nuanced approach. Do keep in mind that there is a difference between intensity and aggressiveness. An engagement approach might be intensive (multiple meetings, letters, etc.) but remains friendly, or it could be intensive but perceived to be hostile. Clarity on the latter point will inform your communication method (next segment).

- **Trust:** Trust is an important element throughout the process. Make sure to orchestrate your approach in a manner that builds trust in your capabilities, in your understanding of the company, in the solution you are proposing to solve the identified problem and your commitment to seeing the issue resolved. If you have trust in the existing C-Suite team or Board, make sure that this is communicated clearly.

Choosing the right engagement approach is essential to the success of a given engagement. Engagers should choose their engagement approach carefully and tailor their approach to the specifics of the sustainability issue and the particulars of the engaged company. One-size-fits-all is not an effective engagement approach.

**Communication Method**
The selected communication method must be consistent with the nature/seriousness of the engagement, its urgency, the culture of the engaged company, and the person or persons you are engaging with. In table 2.0, we will use the boiled egg analogy to characterize the harshness classification of various shareholder-company communication methods:

| Individual Engagement | Collective Engagement |
|---|---|
| Generic Letter (Soft) | Generic Letter (Soft) |
| Tailored Letter/Conference Call (Soft/Medium) | Tailored Letter/Conf. Call (Medium) |
| Periodic/Informal Meeting (in person, virtual) (Soft/Medium) | Periodic/Informal Meeting (in person, virtual) (Medium-Soft/Medium) |
| Special Meeting (in person, virtual) (Medium/Hard) | Special Meeting (in person, virtual) (Hard) |
| Public Communication (press release, media article...) (Medium/Hard) | Public Communication (press release, media article...) (Medium/Hard) |

*Table 2.0*

**Engagement Letter Writing Guidelines**
The selected communication method must be consistent with the nature/seriousness of the engagement, its urgency, the culture of the engaged company, and the person or persons you are engaging with. In table 2.0, we will use the boiled egg analogy to characterize the harshness classification of various shareholder-company communication methods:

1. **Demonstrate your knowledge of the company.** Show that you have done your homework and understand the company's business model and how a particular risk or issue relates to the company's operations. Use language that will resonate with the company, avoiding jargon or acronyms. The same logic applies when meeting with the company, make sure you understand the company business model and challenges before making a peculiar ask, if not limit the meeting to information gathering.
2. **Be Clear.** Early in the letter, communicate the action you are requesting. Many letters build the case first, which pushes the "ask" to near the end where it may be overlooked. Executives are busy people. Say what you want upfront, followed by your supporting arguments. Also, be aware of the counterarguments to your ask, prepare a response for them, and include it in the letter if possible (or in person if you are conversing with the designated officer at the company). Be clear about when and how to expect to receive a response from the company.

3. **Be Concise.** Often, engagers tend to lay out the full business case and all supporting details in every letter, resulting in a document that is so long that it loses impact. Collaborative letters are particularly challenging because signatories want their individual perspectives to be represented. Compromises may be required to achieve the shared end-goal. Use the body of the letter to introduce your points, and use footnotes, weblinks, and appendices to elaborate.
4. **Write to the highest professional standards.** Unfortunately, an alarming number of poorly written letters are circulated for sign-on. A clear, concise, high-quality letter establishes the credibility of both the argument and the author(s). Research your sources to ensure that they are reputable. Always ask someone else to review and edit. Read it aloud, sleep on it, and read it again.

*Some of these letter-writing guidelines were adopted from an article by Anita Green at Wespath Investment Management.

**Internal Communication & Co-ordination**
Engagements can be a tremendous source of information about a company. If the portfolio manager and proxy voting manager are not part of the engagement process, make sure that they are aware of your progress. Likewise, make sure that you are aware of your colleagues' actions in matters pertaining to the engaged company. Close co-ordination within your firm is vital to ensure a successful engagement (Figure 6.0). For multi-asset firms, co-ordination with the debt/fixed income side of the business could be a useful tool to exert additional pressure on the engaged company, thus obtaining better (and potentially faster) engagement outcomes. Proxy voting and cross-assets co-ordination can be a powerful tool to advance your engagement agenda. To ensure timely internal updates and co-ordination, establish weekly, monthly, or quarterly engagement update calls right at the start of the engagement process.

The chosen communication method could have a material impact on the engagement outcome, it is vital that you allocate sufficient time to choosing the right communication method. Alternating communication methods can change the message without changing its wording, alternate tactically. Think of the communication method as the volume dial on your megaphone, adjust it with intent and care.

**d) Establish an Escalation Strategy**
Remember that engagement is about getting people in power (C-Suite, Board members) to do things they might not necessarily agree with. Your job as the engager is to get them to buy into your sustainable vision; this requires a careful balance between offering a carrot and wielding a stick. Keep in mind escalation is expensive and time-consuming, your goal should be to win your engagement without resorting to escalation.

**When/and If to Escalate?**

- The decision to and how far to escalate an engagement (in case of no or slow progress) should be taken prior to the start of the engagement (engagement scope).
- An escalation could take place at any phase during the engagement process. It is a function of the progress, or lack thereof, with the investee company. Missed deadlines and failure to reach key milestones are indicators of a potential need to escalate.
- An escalation could be followed by a de-escalation or vice versa, depending on the progress of the engagement negotiations.
- You should only escalate if you are able and willing to manage the consequences. Escalate when you are ready to do so. Internal backing, buy-in for your escalation strategy must be fully secured prior to initiating an escalation, remain true to your engagement scope.
- Don't jump the gun. A hasty escalation can weaken your position rather than strengthen it, escalate strategically.

**How to Escalate?**

- How to escalate an engagement is highly dependent on where you are in the engagement process. How far are you from your objective? What engagement approach are you pursuing?
- The manner in which you escalate is equally a function of the engagement context, existing regulation, the prevailing stewardship code, the culture of the investee company and country where it is located, the depth of and trust in the relationship between you and the investee company management and board, the size of your investment, and the nature and urgency of your final objective.
- Your ability to de-escalate post escalation should also influence your decision to escalate. Certain escalation strategies (i.e., turning a private engagement into a public one) can't be dialed back easily. Do not paint yourself or the investee company into a corner.
- Make sure the chosen escalation method is consistent with your ultimate goal and stated objectives. Long-term material sustainability objectives require a patient engagement approach and thus a carefully dosed escalation mechanism.

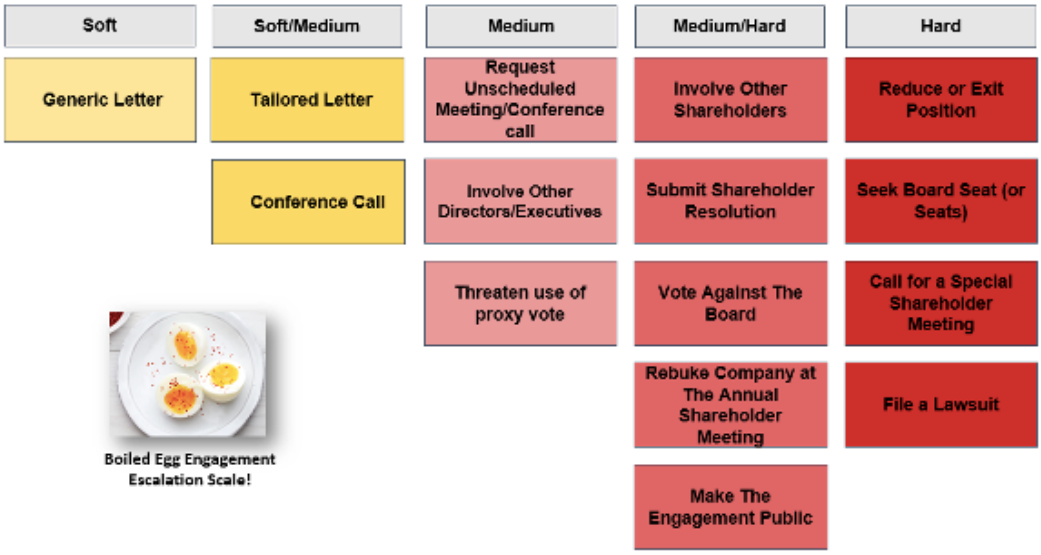


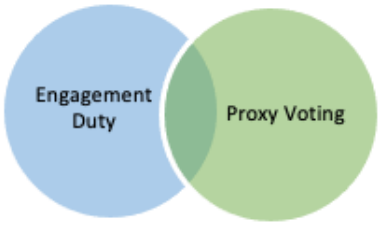

*Figure 11.0 - Escalation Map*

At any given moment of the engagement, be aware of the escalation options available to you. Note that with each escalation, the cost and the complexity of the engagement increases. The goal is to obtain the outcome you desire with the least amount of escalation possible. Always escalate with a valid purpose, 'ego escalations' could lead you to the wrong path. Having a clear engagement objective, scope and approach will help you manage escalation in an informed manner.

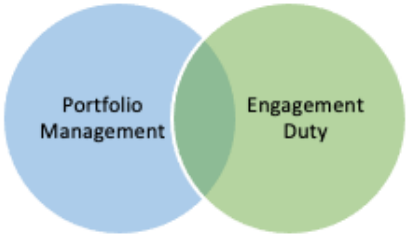
**Who Should Handle the Engagement within Your Firm?**

Asset managers, and asset owners, with an internal engagement capacity, don't have a standard model as to who leads engagements with investee companies. Generally, the engagement job function is embedded within asset management firms under four different models depending on their ESG integration philosophy and their available human resources:


**Triple Duty:** This version embeds the engagement responsibility within the ESG research and proxy voting responsibility. The advantage of this setup is that allows engagement professionals to develop deep ESG expertise, and facilitates coordination with proxy voting. The major drawback of this model is the limited time available to actually engage, and effectively manage engagements, with investee companies.




**Double Duty A:** This version combines the engagement responsibility with the proxy voting function. The advantage of this setup is that it allows a deep dual focus on engagement and proxy voting, functions which are highly complementary. The drawback of this model is the difficulty to engage during the proxy season, a period that can last several months and may consume a substantial amount of time.




D**ouble Duty B:** This version combines the engagement responsibility with the portfolio management function. The advantage of this configuration is that it fosters deep ESG factors integration within the investment approach as portfolio managers systematically address ESG issues in their interactions with portfolio companies. The drawback of this setup is that it risks marginalizing ESG engagements as portfolio managers tend to overweight fundamental factors in their company interactions. Furthermore, extensive engagements can prove distracting to the portfolio manager's capital allocation responsibility.


**Single Duty:** This version dedicates an engagement specialist to the engagement function. The advantage of this model is that it fosters the development of deep engagement expertise, and allows for a large number of engagements. The drawback of this setup is that without proper coordination with the portfolio managers and proxy managers, the engagement function can become disconnected from the rest of the organization, and as a result, it would become less effective.

**What's the ideal number of engagements an engagement specialist should undertake per year?**

**The answer to this question depends on the complexity of the pursued engagements, and the manner the engagement function is embedded in the organization. Based on these factors the range may vary from as little as 20 engagements per year to over 200 engagements per year.**

## Section 3: Engagement Reporting

Reporting on your engagement activity is an essential function and is often required as per recent regulations such as the European Shareholder Directive.

- Reports' Frequency and Accessibility: It is best practice to report on your engagement activity quarterly, followed by a comprehensive annual report at the end of the year. You should also make your engagement data available on your website and update it on a timely basis.

- Reports' Comprehensiveness: Your engagement/stewardship reports could be combined with your proxy voting reports, considering the tight correlation between the two activities. As you expand on your engagement activity, avoid generalities, providing specifics to whom you are engaging with and on what (at least in a general sense, such as under which letter in the ESG spectrum). Sharing milestones, progress reports, and, most importantly outcomes, will add to the value and transparency of your reports. Understandably, some engagements might be best conducted in private. Nonetheless, those can be mentioned without giving many specifics. Your engagement reports should provide sufficient details to provide the reader a true sense of the extent and depth of your engagement activity.

- Record Keeping: Keeping organized, accessible, and traceable engagement activity records will greatly assist you in your engagement reporting activity. Accurate record-keeping will make the reporting function seamless.

- Engagement Impact Reporting: Including information on the metrics/KPIs you are engaging on will provide your clients, partners, and the report readers a better idea of your progress. In sustainability/business matters that can be measured quantitatively, it is good practice to chart the evolution of the engaged upon indicator along your engagement timeline, thus providing an independent gauge of engagement progress.

For Examples of high-quality engagement and stewardship reports, please consult Kempen Asset Management 2019 stewardship report and Schroders Sustainable Investment Q4/20 report.

**Supplementary Resources:**

- ESG Engagement Insights (Link), a presentation by Nawar Alsaadi of best engagement practices of 30 asset managers, owners, pension funds, and non-profits around the world. (The work is derived from BlackRock & Ceres' paper entitled Engagement in the 21st Century).

- ESG Integration Case Studies (Link), a presentation by Nawar Alsaadi of more than 30 ESG integration case studies (Equities and Fixed Income) by a host of asset managers and asset owners around the world. (The work is derived from a CFA Institute and UN-PRI paper entitled Guidance and Case Studies for ESG Integration: Equities and Fixed Income).

- SASB Engagement Guide (Link), a detailed asset managers/owners engagement guide to engage with companies on sustainability issues, indexed by sector and industry.