



# ESG Engagement: State of the Market

## Companies are experiencing an engagement season that is informed by several complex and broad-sweeping developments, including:

1. A continuing surge of investment dollars toward towards environmental, social and governance (ESG) activities.
2. Shifting investor expectations on corporate practices and disclosures, paired with corresponding updates to proxy voting policies.
3. Heightened attention to corporate actions on key ESG topics by employees, customers, policymakers, and other stakeholders.

**To help U.S. companies prepare for engagement meetings, we interviewed about 30 institutional investors on what companies need to know about ESG engagement.** These investors, which combined represent over \$17 trillion in EUM (over \$35 trillion in AUM),<sup>1</sup> include some of the largest and most influential asset managers and asset owners, known for their involvement in governance organizations, ESG standard-setting bodies, and impacts via private-ordering. While some of these investors have long been associated with ESG, most have historically been considered "traditional" in their approaches.

**We addressed our questions to leaders in the investment stewardship, ESG, and sustainable investing functions**—those who sit across the table during engagement conversations and influence engagement and proxy voting decisions. Since the ESG landscape is constantly shifting—such as the nature and scope of the principal ESG frameworks and related collaborations; investor views; their internal processes, systems and structures; and general merger and acquisition activity—the responses, which we collected from July through October 2020, represent views at a specific point in time.

### **Our findings may help companies answer certain questions, such as:**

1. Who participates in engagement conversations and when should a board member be involved?
2. What ESG disclosure frameworks should we consider?
3. How do investors access the information we disclose, especially the data?
4. Who (on the investor's side) determines how our company is viewed from an ESG perspective?
5. How do investors view and track engagement conversations?
6. What kind of feedback might investors give to companies on engagement?

## ESG Takes a Village: How Internal Teams Collaborate on Investor Engagement

### Investor Relations Officer

- The central point of contact on investor engagement, along with the Corporate Secretary or General Counsel.
- Anticipate "pulling-in" internal experts (Board, Sustainability, Human Resources, Supply Chain, and other specialists).
- Be prepared for a substantive conversation on how the company approaches ESG topics that are important to the company, its ESG disclosures and framework(s).
- Understand each key investor's ESG investment strategy, approach and data use to prepare internal experts.
- When coordinating meetings, consider if and when to invite portfolio managers or investment analysts.

### Corporate Secretary or General Counsel

- The central point of contact on investor engagement, along with the Investor Relations Officer.
- Anticipate leveraging in-house governance and disclosure expertise, recognizing that disclosure expectations are shifting.
- Anticipate "pulling-in" internal experts (board, sustainability, human resources, supply chain, and other specialists).
- Be prepared for a substantive conversation on how the company approaches ESG topics that are important to the company, its ESG disclosures and framework(s).
- Prepare board members with high-level talking points on each investor's ESG priorities.

### Board Member

- Meeting participation not always expected, but is useful for enhancing investor understanding of the board's approach to ESG.
- Be prepared to cover the board's approach to:
  - Risk and strategy oversight responsibilities.
  - How key ESG factors are addressed by the business model.
  - How the board works with management.
- Recognize that investors also may simply seek to have their views heard at the board level.
- Get briefed by the Investor Relations Officer, Corporate Secretary or General Counsel on specific investors priorities.

### Sustainability Specialist

- Prepare to discuss the company's public ESG disclosures and approach and alignment to capital markets focused ESG frameworks.
- Be aware of key topics such as materiality and impact on the business model.
- Be aware of key focus areas by key ESG data providers.
- Get briefed by Investor Relations Officer, Corporate Secretary or General Counsel on the specific investors priorities and ESG approach.

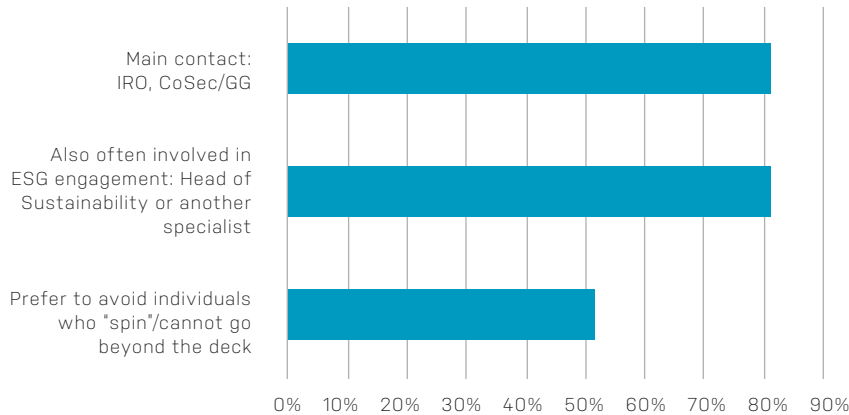
## Who to Invite

### Executives

**Whether it's the company or the investor who initiates the engagement conversation, the main point of contact on the corporate side tends to be the Investor Relations Officer or the Corporate Secretary or General Counsel, depending on the company.** While these individuals may be able to directly respond to an investor's requests, in most cases, investors also connected with the Head of Sustainability and other experts, such as the Chief Human Resources Officer, Head of Supply Chain or Procurement, or a board member.

Note: Investors hold shares in thousands of companies and tend to engage with a wide range of engagement contacts over the course of the year, even at a specific company. Individuals from the corporate side that should participate in engagement discussions depends on their areas of expertise, the topic, the nature of the questions, and the company situation.

### Views on Engagement Participants



Note to the table: Each bar represents the number of investors providing the indicated response and is based on the total interviewed.

#### Key Takeaway

There is frustration over perceived "spin" and lack of candor. Participants need to be prepared for a substantive conversation. Also, the conversation may cover uncomfortable topics, e.g., possible gaps between corporate messaging and diversity numbers.

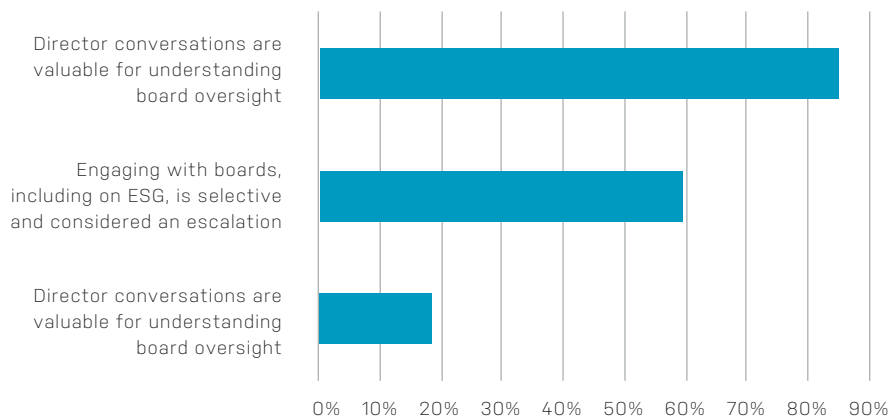
### Board Members

When asked in what situations they would like to have a board member participate in an engagement call, investors noted that board participation is valuable to better understanding the board and:

1. Its approach to risk and strategy oversight responsibilities.
2. How it considers materiality in the context of the company's business model.
3. How it works with management.

Board participation is not always expected nor necessary, but it's useful to have board members available, if requested. Over half of the investors indicated that they tend to seek out the board as an escalation, e.g., when there appears to be controversy, or material unidentified or insufficiently addressed issues.

### What the Board Brings to the Table



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#### Key Takeaway

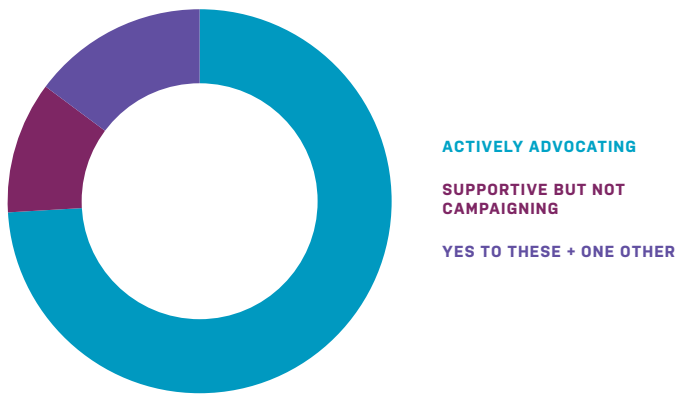
Board participation is valuable for the insights that management cannot provide and for information not readily available in corporate filings. This can be particularly important when there is a controversy or change, e.g., board turnover.

## Selecting Reporting Frameworks

### SASB and TCFD

When asked if they are part of what appears to be an ongoing campaign of advocacy for SASB and TCFD,<sup>2</sup> many of the investors communicated that the push for SASB and TCFD was part of their stewardship work. They noted that SASB offers comparability, a sector lens and focus on what is material for their decision-making. Some investors pointed out that SASB and TCFD provide insights into how a company connects governance to risk and opportunity and how this, in turn, informs strategy and capital allocation. A few also noted that SASB is a useful "starting point" for companies that are new to ESG disclosure since SASB's materiality lens means that these companies are already tracking most of the requested information. Some did say that they also supported another framework (among them, GRI<sup>3</sup> was most often mentioned).

Support and Advocacy for SASB & TCFD



### Key Takeaways

- Investors emphasize the need for comparability and harmonization (regardless of the framework supported), but they recognize that no standard is perfect.
- Companies should communicate which disclosures are most appropriate for their situations

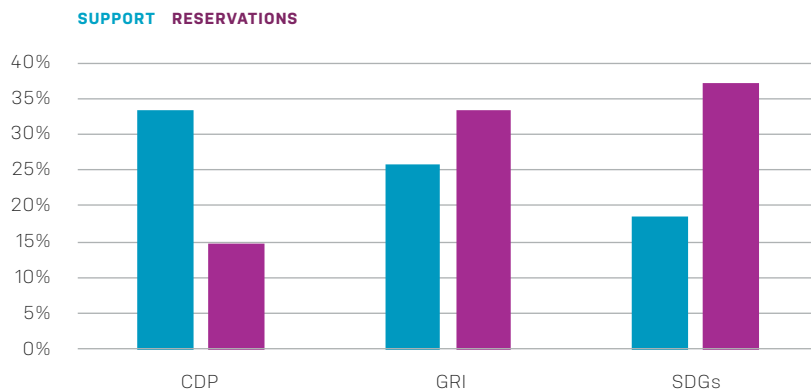
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## Other Approaches to ESG Disclosure

**Some investors took time to share additional comments on other approaches, and these views varied widely.** Of these conversations, CDP<sup>4</sup> appeared to receive the strongest support and least reservations, e.g., there is a preference for public disclosure (over CDP's non-public disclosure option), an observation that CDP questionnaires may have limited applicability, and a view that these were difficult to complete. GRI was seen as being more stakeholder-oriented and less useful for investors' decision-making.

At the same time, some investors commented that certain GRI disclosures, such as on human capital data, can be very important. SDGs<sup>5</sup> appeared to be perceived as more useful for marketing purposes and as having limited applicability, e.g., being better suited for governments and the largest, most complex corporations. Still, some investors noted there was internal interest in the creation of SDG-based products.

Varied Views of Other Approaches



Note to the table: Each column represents the number of investors providing the indicated response and is based on the total interviewed.

### Key Takeaways

- Be aware how business is viewed through an ESG lens, including the frameworks supported by key investors.
- When working to identify a company's key stakeholders, it's important to understand what specific disclosures—not just frameworks—are most useful to the audience.

## Navigating ESG Data and Information

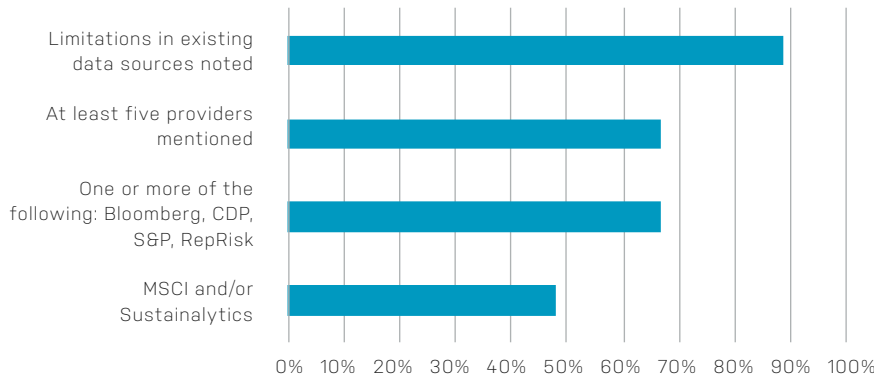
### External Data Providers

**When we shared a list of several ESG data providers (recognizing that there are several more) and asked investors which providers they use, we heard that each investor uses multiple providers.**

Most often referenced were MSCI and Sustainalytics due to the breadth of coverage. At the same time, about two-thirds of the investors mentioned using at least one of four other providers: Bloomberg, CDP, S&P and RepRisk. The majority referenced at least five, and under half noted that each provider has "unique approaches" or limitations.

There was acknowledgement that raw data is important (versus the aggregated scores that were common a few years back), and that it's critical to stay on top of what data is available, changing methodology, and emerging competitors. Some also mentioned use of alternative data, though not in detail.

### Referenced Use of External Data Sources



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#### Key Takeaways

- Provide feedback to key data providers.
- Explain divergent views to your investors.

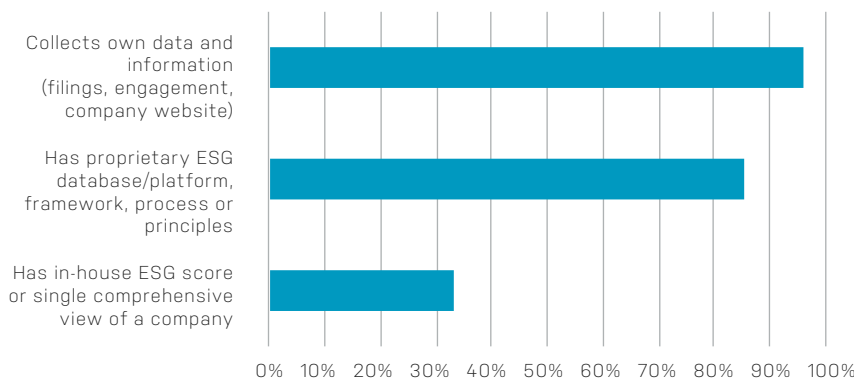
### In-House Information-Sourcing

Only some of the largest investors had a proprietary database and platform for analyzing ESG information or had an in-house "score" or view of a company. Most had some kind of framework, process, or set of principles for analyzing company-specific ESG information. Moreover, some of the less structured approaches appear to potentially be part of a longer-term shift toward a more formalized approach.

Adding to the complexity, investors varied in terms of the extent to which they relied on their own data architectures and methodologies. Most did do some amount of data collection and gathering of contextual information from filings, engagement discussions with companies, or use of the company website, e.g., the sustainability report.

Where the investor had an in-house score or view, the information was typically made widely accessible internally, with access provided to several groups so that they could add their own observations of the company.

### In-house Tools and Information-sourcing



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#### Key Takeaways

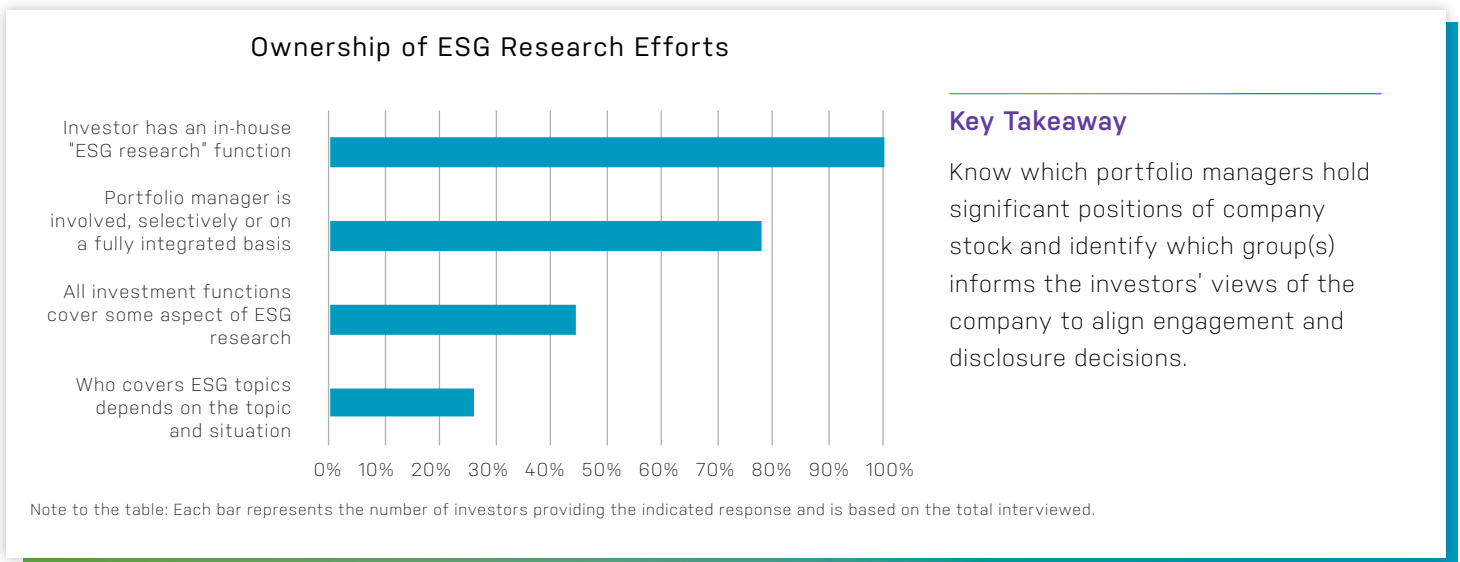
- Investors prefer public disclosure of data, which may be collected directly by investors or indirectly via data providers.
- Be aware that engagement conversations can influence investors' views of the company.

## Stewardship & ESG Integration

### The Approach to Company Research.

**All investors indicated they have their own in-house ESG research capabilities, but their approaches differed widely.** Some described their portfolio managers as being integrated in research and engagement functions, e.g., providing input on a continuous basis, through a committee or more selectively. Others described their portfolio managers as an internal consumer of research findings and recommendations. These investors often had a more centralized ESG or stewardship function.

Depending on the investor, the ESG or stewardship function may cross asset classes or be limited to equities, cross-sectors, or be separate from the sector analysts. In addition, the make-up of the ESG or stewardship group varies. They may include governance and proxy voting specialists, ESG and E+S specialists, researchers, investment analysts, and/or sector analysts.



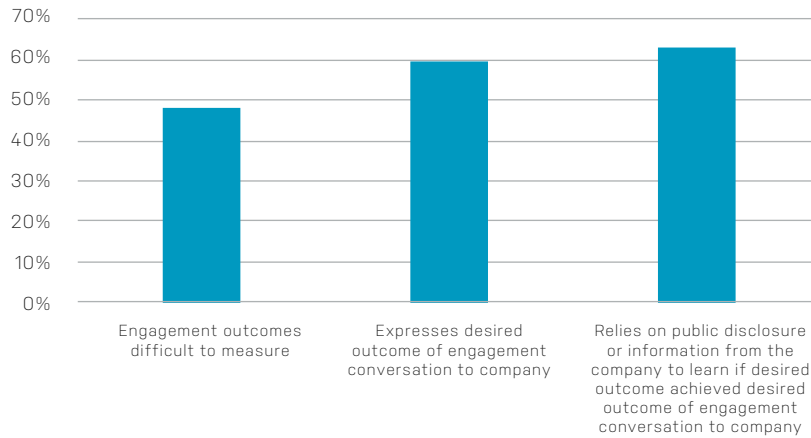
### Tracking Engagement Outcomes

**Investors consistently view engagement as a way to enhance long-term value creation while recognizing that it can be difficult to track the effectiveness of specific conversations.** Investors may share similar priorities—e.g., ESG disclosure frameworks, board diversity—and it can be unclear whether shifts in corporate policies and practices are attributable to pressure from several institutional investors, or one investor.

Some also noted that for complex topics, it may be years before a company undertakes certain actions. Given that some investors are increasingly adopting a more "binary" approach to engagement—in other words, engaging only when there is a specific ask and tracking the outcome—what's increasingly important is companies' public disclosure of requested changes.



### Measuring Engagement Outcomes



#### Key Takeaway

When disagreeing with an investor's specific ask, explain why this is inappropriate for the company at the current time—and provide this information in a publicly accessible vehicle, e.g., the proxy statement

Note to the table: Each column represents the number of investors providing the indicated response and is based on the total interviewed.

## Conclusion

Both companies and investors benefit from thoughtful disclosure of what's most important to a company's business model is helpful to both the company and its investors. This is because public information is driving investors'—and data providers'—understanding of a company. As companies work to identify their chief stakeholders, it's also important for them to understand what specific disclosures—not just frameworks—are most useful to different audiences. These takeaways will become more important over time as ESG integration efforts continue, and portfolio managers and products become more closely aligned with ESG and stewardship functions.

## Nasdaq ESG Solutions:

**Nasdaq ESG Advisory Program** pairs companies with consultative ESG expertise to help companies analyze, assess and action ESG program best practices with the goals of attracting long-term capital and enhancing value.

**Nasdaq OneReport** is a platform that provides companies with more control and efficiencies throughout their ESG data management and reporting processes, empowering them with tools designed to help them navigate the evolving ESG landscape and optimize outcomes.

## Feedback on Engagement Conversations

### What We Learned

We asked for recommendations about what's most helpful for engagement conversations and what's best avoided.

### Approach to Engagement

STAKEHOLDER(S)	DO'S	DON'TS
Board Member Investor Relations Officer Corporate Secretary General Counsel Head of Sustainability	<ul style="list-style-type: none"> <li>• Be able to articulate key material ESG risks and opportunities for the business.               <ul style="list-style-type: none"> <li>» What are the company's top five ESG considerations?</li> <li>» How does the board oversee these ESG topics?</li> <li>» How are these ESG topics integrated into strategy and operations?</li> </ul> </li> <li>• Recognize that those investors engaging on ESG are focused on how it is reflected in the company's business strategy and risk—not a company's charitable endeavors or volunteer work. Hence attention to the SASB framework.</li> </ul>	<ul style="list-style-type: none"> <li>• Avoid greenwashing or "winging" conversations. There's growing attention to perceived gaps between a company's messaging and action.               <ul style="list-style-type: none"> <li>» Discussions of ESG matters often require different expertise. This is an opportunity to showcase the company's work on key topics.</li> </ul> </li> <li>• Don't assume that investors are approaching ESG as a "fluffy" or values-based area. Investors view ESG engagement as a way to create and protect companies' long-term value.</li> </ul>
Investor Relations Officer Corporate Secretary General Counsel Head of Sustainability	<ul style="list-style-type: none"> <li>• Engagement is a good opportunity to inform key investors about how the company views ESG (e.g., where the company is in terms of its "ESG journey").               <ul style="list-style-type: none"> <li>» Push back as appropriate to explain why certain disclosures may be more important to the company's business model than others.</li> </ul> </li> <li>• Data disclosure (e.g., current status, quantitative targets) paired with contextual narratives (qualitative targets) are imperative for investors and other stakeholders, such as data providers.</li> </ul>	<ul style="list-style-type: none"> <li>• Don't box-check, such as engaging for the sake of saying that there was engagement, chasing a rating, or providing disclosure on issues that are not material to the company's business.               <ul style="list-style-type: none"> <li>» Instead, focus on what's most important for the business.</li> </ul> </li> </ul>
Investor Relations Officer Corporate Secretary General Counsel	<ul style="list-style-type: none"> <li>• Recognize that investors have their own view and can offer useful perspectives, and that they are "never just investors" (e.g., they may represent multiple stakeholders, such as being employees whose pension needs have long-term horizons).</li> <li>• Prepare for engagement by:               <ul style="list-style-type: none"> <li>» Understanding if the investor is active or passive, an asset manager or owner, hedge fund activist or actively engaged because this is likely to affect their investment time horizon, the nature of their asks, and whether—and to what extent—they will be long-term shareholders.</li> <li>» Reviewing investment stewardship reports, thought leadership, and proxy voting policies to gain more knowledge of investor positions. Some also may engage via letter-writing or shareholder proposals.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Don't go into discussions critical of proxy advisory firms, nor assume that investors blindly follow their recommendations.               <ul style="list-style-type: none"> <li>» Investors will have their own proxy voting priorities and may be unaware of leading proxy advisory firms' recommendations.</li> </ul> </li> <li>• Don't assume that investors are "there to disrupt things" or are "tree-huggers." They are not.               <ul style="list-style-type: none"> <li>» As an example, the focus on SASB reporting reflect attention to material business considerations.</li> </ul> </li> </ul>

## Meeting Planning

STAKEHOLDER(S)	DO'S	DON'TS
Investor Relations Officer Corporate Secretary General Counsel	<ul style="list-style-type: none"> <li>• Have an agenda for the engagement call—ideally one that is mutually agreed upon—and make sure the right people participate. This provides for a more productive use of time for all.                             <ul style="list-style-type: none"> <li>» Reach out to the investment base and industry group to see if a conversation would be helpful, specific topics would be useful, or to raise the idea of including certain individuals and specialists.</li> <li>» If a requested board member cannot participate, consider someone who reports to that board member.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Avoid reaching out last minute for a meeting that requires investor action (e.g., shortly before the annual meeting or proxy vote, especially during proxy season).</li> </ul>
Board Member Investor Relations Officer Corporate Secretary General Counsel	<ul style="list-style-type: none"> <li>• Anticipate the potential for ongoing conversations and engagement, since ESG topics are viewed as "evolutionary" (e.g., where changes are understood to occur over time, versus one-off conversations).</li> <li>• Consider how hearing investors' views might potentially inform company actions and disclosures, and be prepared to address these topics.</li> </ul>	<ul style="list-style-type: none"> <li>• Engagement calls are not earnings calls.                             <ul style="list-style-type: none"> <li>» Avoid overly positive (e.g., "marketing" or "sales" oriented) language that may unintentionally come across as sidestepping uncomfortable questions.</li> <li>» Anticipate back and forth discussion and listening opportunities throughout.</li> </ul> </li> </ul>

1. AUM data based on available information from company websites, as of November 16, 2020.
2. SASB (Sustainability Accounting Standards Board) manages standards for sustainability reporting that are geared toward investor needs. TCFD (Task Force on Climate-related Financial Disclosures) recommendations provide for climate-related disclosures aimed at promoting more informed investment, credit, and insurance underwriting decisions.
3. GRI (Global Reporting Initiative) manages the world's most widely used standards for sustainability reporting.
4. CDP runs a disclosure system for investors, companies, cities, states and regions to manage their environmental impacts.
5. SDGs (Sustainable Development Goals) are elements of a United Nations created blueprint for sustainable development and represent the call to action by all countries in a global partnership.

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