# STRATEGIC INVESTOR ENGAGEMENT: DRIVING STEWARDSHIP FOR A NET ZERO FUTURE

Deborah Christie
Managing Director
Public Equities

Marie Ang
Investment Director
Sustainable & Impact Investing

To accelerate net zero objectives, investors are well placed to leverage their voice as asset owners through stewardship and engagement activities with investments not aligned with a net zero pathway.[1] Climate-related engagement can yield significant positive outcomes, and there are multiple ways to engage depending on an investor's capacity and resources. Recent research shows that material engagement can be an effective tool associated with companies reducing downside risk, decreasing carbon emissions, and improving profitability.[2] This paper serves as an introduction to net zero engagement activity for asset owners. We provide an overview of three strategies for deeper engagement with examples from institutional investor case studies.

**DEFINING STEWARDSHIP AND ENGAGEMENT**

As defined by the UK Stewardship Code, stewardship is the responsible allocation, management, and oversight of capital to create long-term value for investors leading to sustainable benefits for the economy, the environment, and society. Engagement puts stewardship into action—it is purposeful dialogue with a specific and targeted objective, according to The Investor Forum. Engagement is a meaningful part of investment activity and a means for fiduciaries to promote accountability.

## Engagement and Net Zero Policy Goals

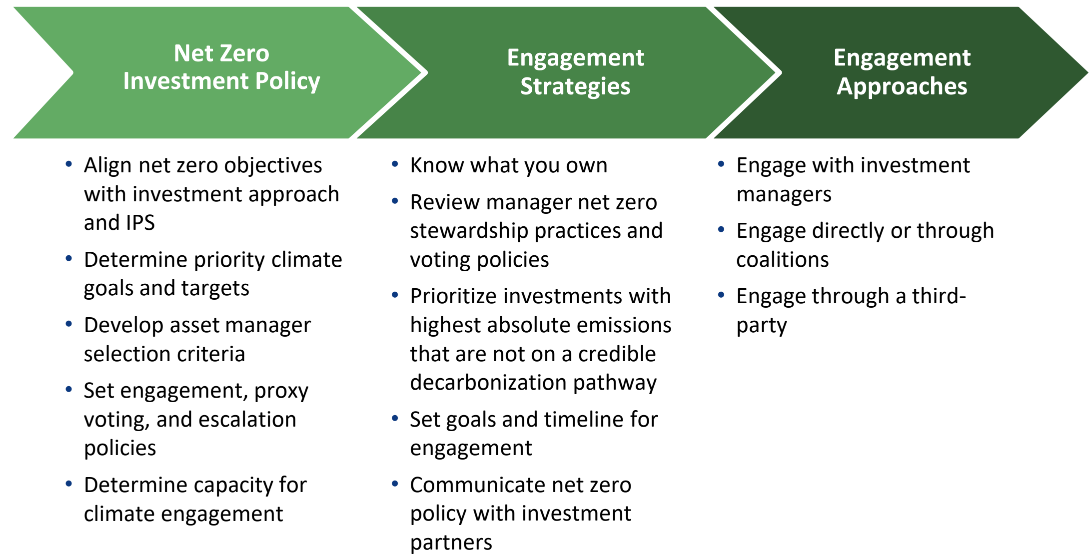
In a net zero context, the objective of engagement is to align company business plans with the Paris Agreement objective of a 1.5-degree Celsius scenario, beginning with decarbonizing the real economy through investing in transition assets and establishing credible transition plans and science-based targets. Engagement is an essential element of a net zero investment policy, which clearly articulates net zero goals and provides framing for priorities, investment manager selection, and engagement.

An engagement policy should include setting expectations of its investment managers' approach to engagement, proxy voting, and escalation. An escalation policy outlines general steps for increasing engagement with a manager or companies to promote behavior change and its general timeline to assess developments before determining whether to dissolve the relationship. With these policies crafted, investors have a road map to engage more deeply in net zero, both with existing and prospective investment managers (Figure 1). The Appendix lists some resources available to help asset owners on their engagement journey.

Published October 1, 2023

CAMBRIDGE ASSOCIATES

**FIGURE 1 ENGAGEMENT PATHWAY**




Source: Cambridge Associates LLC.

## Strategies for Deeper Engagement

Investors should determine their capacity for climate engagement and decide what potential approaches best fit their team as part of their theory of change, especially as some engagements can be multiyear efforts. Investors can use various engagement methods. Figure 2 outlines the three major approaches.

**FIGURE 2 THREE MAIN ENGAGEMENT METHODS**

1. **Engage with Investment Managers**
2. **Engage Directly or Through Coalitions**
3. **Engage Through a Third Party**

Source: Cambridge Associates LLC.

To start, investors and their advisers should understand what they already own by reviewing their investment managers and portfolio holdings and evaluating whether they are aligned with a net zero pathway. This should include a review of each manager's net zero and engagement policies and practices. Investment managers need a strong ability to assess an investment's net zero activities to accurately price a company's alignment. Investment managers can drive change by interacting with non-aligned investments and staying invested in high-emitting sectors as active shareholders, thus encouraging a shift toward sustainable practices. Managers with strong engagement practices will have a clear thesis on the materiality of engagement topics such as net zero, a well-equipped engagement team that contributes to the work of investment teams, a clear strategy for engagement escalation and proxy voting with associated milestones, transparent reporting to investors, and an outcomes-based focus that recognizes the long-term nature of engagements for meaningful change.

After a review, an investor can then easily prioritize investments to engage with. Examples include engaging with managers where there is the greatest exposure to non-aligned or non-transitioning assets, or engaging with managers that do not have a strategy for their portfolios to be aligned with net zero objectives by 2050.

### ENGAGE WITH INVESTMENT MANAGERS

When engaging with managers about net zero, investors have an important opportunity to convey how a net zero strategy can help enhance returns given the systemic risks and rewards in a transitioning world. This communication can come in the form of written letters and meetings to discuss a manager's plan (or lack thereof) to engage with and align portfolio companies with a net zero pathway. If managers do not show adequate action over a reasonable amount of time, an escalation policy might come into play.

Engaging with passive index providers is as important as engaging with active investment managers, particularly as systemic climate change risks materially threaten market-wide returns (i.e., beta). Index providers cannot diversify away from systemic risks and can only address systemic threats by effecting real world change. Indexes are therefore effectively "universal" owners in what protects the long-term health of the system as a whole to preserve long-term returns.

These efforts are most applicable to marketable securities. But private investments also play a significant role in achieving net zero goals, whether by funding climate solutions or funding net zero–aligned high-growth companies that will be the industry leaders of tomorrow. General partners have a high degree of influence over portfolio companies and therefore a particular responsibility to achieve positive outcomes via engagement, as part of their wider value enhancement activities. Investors should allocate capital to managers with a clear playbook to limit climate risk and reduce carbon intensity across their value chain. The Initiative Climat International's (iCI) Decarbonisation Roadmap and the Institutional Investors Group on Climate Change (IIGCC)'s Net Zero Investment Framework for the Private Equity Industry provide a clear pathway toward assessing, setting targets, and engaging in net zero alignment. Again, making sure that an investor's net zero objectives are clearly communicated to investment managers should help ensure better alignment across a portfolio, while sending an important signal to the wider private market community.

### ENGAGE DIRECTLY OR THROUGH COLLABORATIVE INITIATIVES

Direct engagement with company management, either individually or through peer coalitions, is another viable approach. If seeking to engage with companies, the IIGCC's Net Zero Stewardship Toolkit is a useful resource to develop an approach. However, engaging with companies individually can be time consuming, and specific expertise and dedicated staff resources are required to manage and implement the engagement. Many investors find it simpler to work with collaborative investor coalitions that help coordinate, reduce duplicative efforts, and frame the engagement process on behalf of investors. Research shows that such collaborative initiatives positively contribute to the effectiveness of engagements over environmental, social, and governance (ESG) topics.[3] By joining wider coalitions, investors can leverage collective bargaining power and create broader visibility of issues. There are a range of organizations (e.g., Interfaith Center on Corporate Responsibility, UN Principles for Responsible Investment, Climate Action 100+, IIGCC) for investors to join and take action together. Engagements through these groups can include lower touch actions such as signing onto joint letters (groups such as Nature Action 100, IIGCC Net Zero Engagement Initiative, and ShareAction facilitate these). Higher touch engagements can include leading or co-leading a deeper discussion and engagement with a company typically held over a 12-month period. Figure 3 outlines a wide range of actions an investor can pursue, including ways to leverage shares through coalitions. Investors cannot engage with every holding, so it is important to prioritize initiatives that focus on portfolio components with the highest emissions reduction potential and that may be under-engaged by other investors.

Collaborative investor groups also engage on industry-specific and national regulations in favor of policies which support systems-level net zero alignment, such as mandating emissions disclosures, removing subsidies from polluting industries, and creating set guardrails and targets consistent with net zero. Engagement here should focus on the largest cost and regulatory barriers hindering the pace of private sector action.

**FIGURE 3 SPECIFIC ACTIONS ASSET OWNERS CAN DO TO ENGAGE**

| | Level of Effort | | |
|---|---|---|---|
| **Engage with Investment Managers** | | | |
| Seek manager acknowledgment of asset owner net zero policy in side letter or direct letters | ✓ | | |
| Seek annual meetings with managers to discuss net zero target goals and outcomes | | ✓ | |
| Encourage your AMs to be part of a collaborative group | ✓ | | |
| **Engage Directly or Through Coalitions** | | | |
| Join a collaborative group and sign group letters | ✓ | | |
| Sign a joint private or public letter addressed to management or the board | ✓ | | |
| Openly support managers that are engaging or filing a shareholder proposal | | ✓ | |
| Participate at AGMs through public statements or questions | | ✓ | |
| Participate in working groups or (co-)lead an engagement | | | ✓ |
| **Engage Through a Third Party** | | | |
| Determine and customize preferences to be implemented by an overlay provider | ✓ | | |
| Seek annual meetings with your third-party providers to discuss net zero | | ✓ | |

Source: Cambridge Associates LLC.

### EMPLOY A THIRD-PARTY SERVICE FOR ENGAGEMENT SUPPORT

Investors can focus their engagement capabilities by hiring third-party services to perform engagement and/or voting services. Investors can specify their climate priorities, engagement preferences, and voting predisposition from the provider's options to be executed by the overlay service that takes over responsibilities from the asset manager. Outsourcing can be simple, but expensive to execute. We instead encourage asset owners to select managers that are aligned on net zero objectives in the first instance. However, overlay services may suit investors who prefer to select and invest directly into listed equities through separately managed accounts and do not have the staff to manage engagement and voting activity, as opposed to investors who invest through selecting asset managers.

## Case Studies

Asset owners can use multiple tools and approaches to engage for climate objectives. Here are three illustrative examples of global asset owners engaging in net zero in different ways and levels of engagement with multiple beneficial outcomes. Each asset owner's effectiveness came from persistence in their multiyear efforts and a focus on accountability from their investments.

### CASE STUDY 1: A CONSERVATION AND NATURE FOUNDATION (CNF)

**Mission:** To preserve natural and historical places, with a strong focus on promoting net zero and biodiversity across geographies.

**Engagement Approach:** Combination of engaging with managers and collaboration with several coalitions. The Trustees developed an ambitious net zero policy and approach to engagement, which includes:

- A sub-committee that conducts annual investment manager reviews looking at each manager's ESG and stewardship teams, ESG integration, ongoing net zero alignment and climate risk management, engagement, and voting activity, and progress since the last meeting.
- Targeted collaboration with other asset managers and asset owners through coalitions such as Climate Action 100+ (CA100+) where CNF has successfully co-led direct engagements with high-emitting companies and participated in industry consultations.

Annual manager reviews provide information on the net zero alignment of the overall portfolio, which helps CNF determine where changes to managers or the portfolio might need to be made.

**Outcomes:** The investor's pressure and accountability mechanism of regular meetings has contributed to many of the managers formalizing and enhancing their approach to ESG and net zero, as well as their reporting practices. Their leadership in a collaborative engagement led to a company aligning its corporate disclosures in accordance with the CA100+ NZ Company Benchmark indicators.

**CASE STUDY 2: A UNIVERSITY ENDOWMENT (UE)**

**Mission:** This prominent university has a history of scientific discovery and is focused on developing and commercializing solutions to accelerate a transition toward net zero.

**Engagement Approach:** Combination of engaging directly with companies, managers, and several coalitions and, at times, leveraging their student population to participate in engagement activities. The UE has a focused approach to engage with banks that lend to fossil fuel companies because banks provide the largest share of fossil fuel financing, and new fossil fuel infrastructure results in 30 years of new carbon emissions. UE engages both directly with banking management and through coalitions. UE also engages with their managers about fossil fuel financing. They focus on three simple questions:

- Did the manager vote against the re-election of directors of companies on the CA100+ list based on climate-related concerns and make clear that climate was a reason for the vote against the directors?
- How many climate plans of banks did the manager vote against?
- How many primary market investments (i.e., new bond issues, initial public offerings, equity issues) did the firm invest into new fossil fuel infrastructure?

Annual answers to these questions then set escalation priorities, which include the threat of termination.

**Outcomes:** Focusing engagement priorities with managers makes engagement unambiguous and monitoring outcomes (i.e., letter writing campaigns, collaborative efforts, and manager engagement) easier to accomplish. For example, UE successfully contributed to increased emissions disclosure by a global bank and hastened another bank's timeline in phasing down fossil fuel financing.

**CASE STUDY 3: A PENSION**

**Mission:** A medium-sized, multi-billion dollar pension takes the perspective of a universal owner.* The institution's focus is therefore on making real world changes for the benefit of the entire financial system and real economy, and actively engaging to raise the bar for global standards for especially polluting industries.

**Engagement Approach:** Combination of engaging with managers, companies, coalitions, and an overlay service. As part of the pension's engagement plan, the pension meets with each manager annually and conducts a net zero portfolio analysis, following up with each manager with action items. While the pension hires asset managers, it maintains the ability to engage directly and vote custom policies through an overlay provider. The pension has a sizable investment team with multiple staff solely dedicated to engagement and stewardship activities including:

- Engaging directly with companies;
- Writing public letters, publicly pre-declaring votes, asking questions, and filing shareholder resolutions at annual general meetings if direct engagement does not yield success;
- Publicly divesting from companies, as an act of last resort, if protracted, multiyear engagement is not affecting meaningful improvement with net zero alignment; and
- Participating with major coalitions and regularly interacting with regulators, policy makers, and the financial community to promote momentum on climate.

**Outcomes:** The pension leverages its visibility and influence as a coalition builder—stepping in to create partnerships on themes that are not already addressed by other coalitions. For example, the pension has led or co-led initiatives to establish industry frameworks and standards addressing systemic challenges. In one case, the pension's persistent engagement led half of the target companies to officially adopt or consider the standard, reducing risks associated with the industry.

* The institution has an interest in the long-term health of the financial system as a whole and that because assets are so large, it cannot diversify away from systemic risks such as the climate crisis and biodiversity loss.

As evidenced in the case studies, climate-related engagement can yield significant positive outcomes, and there are multiple ways of engaging depending on an investor's capacity and resources. Engagement programs and relationships with investment managers take time to establish, and meaningful outcomes can be the fruit of multi-year processes. But it can start with an action as simple as endorsing a letter through a collaborative engagement group or writing to a manager for greater insight on their net zero engagement practices. As asset owners become more comfortable, more tools can be added to a suite of actions.

## Conclusion

Engagement is the opportunity for investors to bring their voices to the table and practice their fiduciary responsibility to participate actively in the global effort to reduce real world greenhouse gas emissions. If left unabated, these emissions will result in catastrophic impact born from physical and transition risks, which pose significant, underpriced dangers to the global economy, the global financial system, asset values, and, ultimately, portfolio returns.

The financial materiality of the climate crisis requires fiduciaries to protect their portfolios from the risks presented by climate change, while investing in opportunities to transition to a low-carbon economy.[4] Collective participation is needed, and accountability mechanisms are important. As shown through the case studies, asset owner participation can be a powerful voice to encourage climate risk disclosures and align portfolios on the net zero pathway. Engagement is an imperative toward positively impacting the real economy and protecting portfolios.[5,6] ■

1 See Simon Hallett and Sarah Edwards, "From Policy to Implementation: A Net Zero Playbook for Investors," Cambridge Associates LLC, 2023.

2 Rob Bauer, Jeroen Derwall and Colin Tissen, Private Shareholder Engagements on Material ESG Issues, May 31, 2023. And Hoepner, Andreas G. F. and Oikonomou, Ioannis and Sautner, Zacharias and Starks, Laura T. and Zhou, Xiaoyan, ESG Shareholder Engagement and Downside Risk (November 2022). AFA 2018 paper, European Corporate Governance Institute – Finance Working Paper No. 671/2020; and 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.

3 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.

4 See Freshfields Bruckhaus Deringer, "A Legal Framework for Impact: Sustainability Impact in Investor Decision-Making," UN Environment Programme Finance Initiative, July 2021.

5 IPCC, Sixth Assessment Report, Climate Change 2022: Impacts, Adaptation and Vulnerability, 2023.

6 Bank of England, 2021 Climate Biennial Exploratory Scenario, 2022.

## Appendix

| Name | Description | Resources |
|---|---|---|
| ICSWG-UK<br>Investment Consultants Sustainability Working Group | A collaboration among UK investment consulting firms to engage with stakeholders and empower asset owners, to advance sustainable investment practices across the investment industry. | Engagement Reporting Guide, 2021 |
| IEN<br>Intentional Endowments Network | The network aims to connect intentional and like-minded endowments that aim to generate strong financial returns while supporting an equitable and low carbon economy. The network also provides opportunities for education and peer networking. | Shareholder Engagement Initiative |
| IIGCC<br>Institutional Investors Group on Climate Change | A membership body supporting institutional investors drive real and significant progress toward a net zero and resilient future. | IIGCC Net Zero Asset Owner Stewardship Questionnaire<br>IIGCC Net Zero Stewardship Toolkit |
| The Investor Forum | An institutional investor membership organization focused on stewardship. | Defining Stewardship and Engagement, 2019<br>Collective Engagement: An Essential Stewardship Capability, 2019<br>Engaging the Engagers, 2020 |
| UNPRI<br>UN Principles for Responsible Investment | A UN supported international network of financial institutions working to understand the implications of sustainability for investors and contribute to the development of a more sustainable global financial system. | ESG Engagement for Fixed Income Investors<br>A Practical Guide to Active Ownership in Listed Equity<br>NZAOA The Future of Investor Engagement |