# International Platform on Sustainable Finance

## Stewardship and engagement in transition finance note
## November 2024

# IPSF Transition Finance Working Group

# Workstream: Stewardship and engagement


## Executive Summary

Effective stewardship, defined as the proactive ownership practices employed by financial institutions to influence the behavior of investee companies towards achieving long-term positive sustainability outcomes, is a crucial aspect of transition finance. Stewardship and engagement strategies are expected to become a core element of transition planning and transition plan disclosures, as already envisaged by several net zero alliances and regulators.

The review of key existing stewardship and engagement frameworks reveals that they have several core components in common, including policy definition, risk and opportunity identification, governance, voting, engagement strategies, escalation procedures, monitoring, delegation, transparency, and public policy advocacy.

Still, several best practice elements that could strengthen the effectiveness of stewardship strategies have yet to be mainstreamed across frameworks. These include: 1) expanding and mainstreaming stewardship strategies to cover more assets, voting items and capital allocation decisions, as well as voting out directors who fail to address important sustainability concerns, 2) ensuring comparable, structured and timely transparency on stewardship strategies, implementation and outcomes, 3) embedding continuous improvement into frameworks, and 4) designing policies to mainstream stewardship disclosures and remove hurdles to active ownership and collaborative engagement.

# 1. Introduction

Stewardship in sustainable finance refers to the proactive ownership practices employed by financial institutions to influence the behavior of investee companies towards achieving long-term environmental and social sustainability, aligning with a net zero and climate-resilient economy. These practices include exercising shareholder rights through engagement and voting, encouraging companies to adopt strategies that support the transition to net-zero emissions and mitigate climate-related risks. Although stewardship and engagement are often used interchangeably, engagement usually refers to a specific aspect of stewardship that focuses on the direct interaction between investors and investee companies with the aim of eliciting specific changes or actions. We nonetheless note that financial institutions, given the wide array of financial services (e.g. capital market solutions, credit and insurance provision) that they provide, can have a broader engagement role to play to enhance their sustainability impact. Client engagement is one key avenue and can involve advising clients on sustainable financial products, services and strategies, including engagement strategies.

Given the need to decarbonize carbon-intensive and hard-to-abate companies, stewardship is heralded as an important transition finance instrument that allows investors to generate positive and mitigate negative impact. Engagement is a central element of many transition planning and transition plan frameworks[1]. It is a potentially important lever for financial institutions to promote the transition through their investments, especially when combined with a clear escalation policy that may culminate in exclusions. It is a key element to ensure the credibility and impact of financial institutions' managed phaseout strategies[2], and can also help those institutions with the disclosure of managed phaseout plans, as envisaged in some sector-specific transition plan frameworks[3].

Stewardship is only one of many levers that can support the transition but it cannot replace a broader overarching and multifaceted policy framework that supports and incentivizes the entire economy to transition to net zero and sustainability more broadly. In fact, stewardship is only an indirect way of influencing strategic and operational decisions of financed companies. Changes in investee company behavior might not always be directly attributable to engagement activities. Still, there is value in seeking to identify the most effective ways to structure and carry out stewardship.
Effective stewardship not only contributes to systemic risk mitigation and resilience but also fosters long-term value creation for both companies and investors, thus aligning with fiduciary duty. This is based on the understanding that taking sustainability and climate change considerations into financial decision-making aligns with the broad interests of long-term investors and thus supports both goals of generating returns and ensuring sustainability[4].

While stewardship typically encompasses environmental, social, and governance (ESG) factors and ties into Corporate Social Responsibility (CSR) efforts and corporate governance codes, this discussion focuses primarily on environmental stewardship. It emphasizes the critical role

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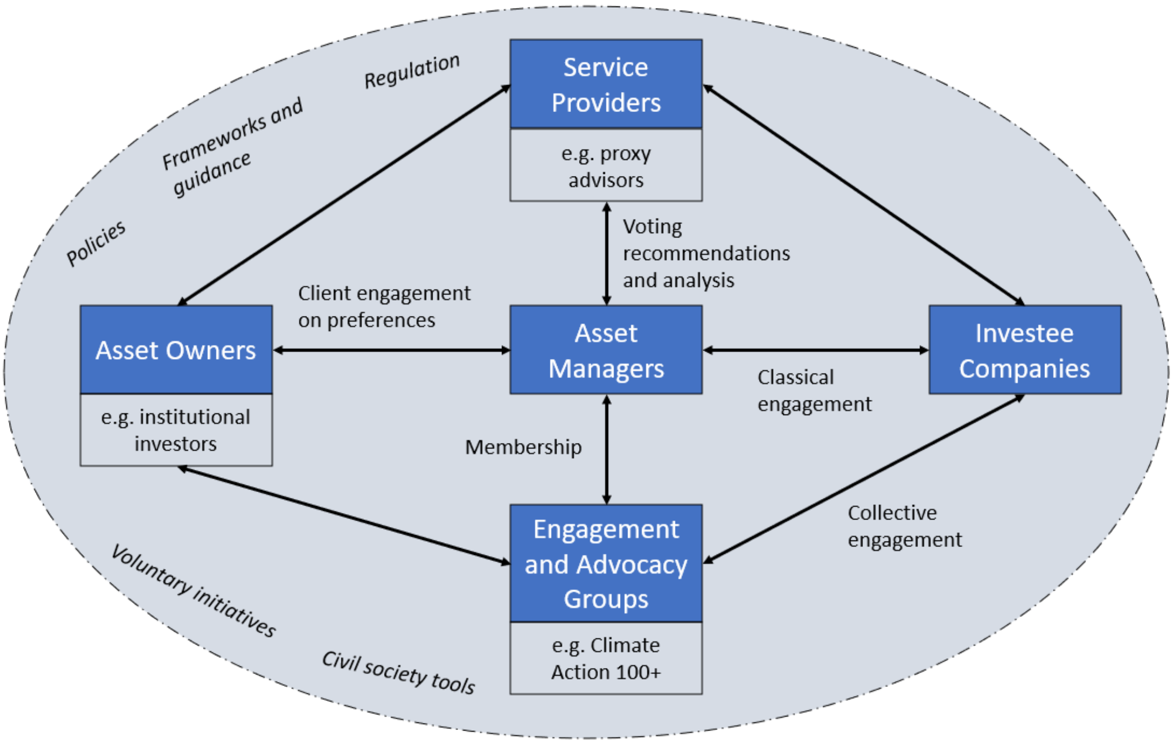
[1] E.g. TPT disclosure-framework-oct-2023.pdf (ifrs.org), NGFS - Transition Plan Package | NGFS
[2] E.g. GFANZ Recommendations-and-Guidance-on-Financial-Institution-Net-zero-Transition-Plans-November-2022.pdf (bbhub.io)
[3] Eg. TPT-Asset-Manager-Sector-Guidance.pdf (transitiontaskforce.net)
[4] E.g. FMLC on pension fund trustees: Paper-Pension-Fund-Trustees-and-Fiduciary-Duties-Decision-making-in-the-context-of-Sustainability-and-the-subject-of-Climate-Change-6-February-2024.pdf (fmlc.org)

of financial institutions in better aligning financial flows with environmental objectives and in refraining from environmentally deleterious practices. Stewardship involves a broad range of actors including institutional investors, asset managers, asset owners, service providers and collective engagement groups, and covers various asset classes and stakeholders. Fig. 1 provides an overview of the central actors in the stewardship ecosystem and the policy environment (e.g. policies, frameworks, initiatives) that they operate in. The policy frameworks, initiatives and tools will be the focus of this paper.

**Fig. 1: Key actors in the stewardship ecosystem**




This paper is structured as follows: Section 2 provides a mapping of key initiatives in the realm of stewardship and engagement, categorizing them into stewardship codes and principles, engagement frameworks, investor-led networks, and supportive tools. Section 3 distills the common elements across these initiatives, identifying baseline practices in stewardship and engagement. Section 4 outlines best practice elements, offering insights on policy definition, governance, voting, engagement strategies, escalation procedures, monitoring, delegation to service providers, transparency, and further supportive elements. Finally, Section 5 concludes with recommendations for developing robust stewardship strategies.

## 2. Mapping of Key Initiatives

The landscape of engagement and stewardship in sustainable finance encompasses a variety of initiatives that promote responsible investment practices and drive the transition to a sustainable economy. These initiatives can be categorized into several key types:

- stewardship codes and principles or regulatory frameworks
- engagement frameworks of net zero alliances
- investor-led networks, and supportive tools, and
- instruments provided by civil society.

This multifaceted ecosystem provides financial institutions with mostly voluntary guidelines, collaborative platforms, and resources to exercise their stewardship responsibilities.

### 2.1 Stewardship Codes and Principles or regulatory frameworks

Stewardship codes and principles, developed by industry initiatives or governments, form the foundation of responsible investment practices. These codes provide frameworks for institutional investors to engage with investee companies on ESG issues and promote long-term sustainability, usually on a voluntary basis. The following section gives an overview of a few key codes and principles but is not meant to be an exhaustive list.

The United Nations-supported Principles for Responsible Investment (PRI) is one of the most widely recognized initiatives internationally, offering a comprehensive set of principles that encourage investors to incorporate ESG factors into their investment decisions and ownership practices. Founded in 2006, the PRI aims to understand the investment implications of ESG factors and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions. The PRI's six principles provide a voluntary framework to help investors integrate ESG considerations into their investment processes. These principles emphasize active ownership, encouraging investors to engage with companies on ESG issues, and to use their shareholder rights to influence corporate behavior. The PRI also offers a range of resources, including guidance documents, case studies, and reporting frameworks, to support signatories in implementing these principles. Furthermore, the PRI facilitates collaboration among investors to amplify their impact, organizes events and webinars for knowledge sharing, and engages with policymakers to advocate for sustainable financial markets.

The International Corporate Governance Network (ICGN) Global Stewardship Principles offer another significant set of voluntary guidelines, advocating for investor responsibilities in stewardship, including monitoring and engaging with companies to ensure robust governance and sustainability practices. Established in 2016, the ICGN Principles outline best practices for institutional investors to manage their fiduciary duties effectively. The principles also highlight the need for investors to collaborate with other stakeholders, participate in the governance processes of investee companies, and report on their stewardship activities. These principles align with efforts at jurisdictional level that emphasize transparency, accountability, and active engagement by shareholders.

Building on the UN Guiding Principles on Business and Human Rights (UN Guiding Principles), the OECD Guidelines for Multinational Enterprises on Responsible Business Conduct and the related OECD Due Diligence Guidance for Responsible Business Conduct recognize the responsibility of companies – including in the financial sector – to exercise due diligence with respect to ESG topics, and to mitigate the adverse impacts arising in their own operations and their value chains. For the financial sector, part of the due diligence requirement is to engage with clients/investee companies with a view to prevent and bring to an end human rights violations, as well as social and environmental impacts in client relationships and investee companies. The OECD has also adopted specific sectoral guidance for the financial sector, including on institutional investor activities, on corporate lending and securities underwriting, on project and asset finance transactions, and most recently on managing climate risks and impacts. Stewardship is an important step in the sustainability responsible business conduct due diligence with respect to investee companies and clients also in the context of preventing and mitigating actual or potential adverse climate impacts.

National and sectoral stewardship codes tailor the principles of responsible investment to specific jurisdictions and industries or aim to contribute to strengthening international best practice. The UK Stewardship Code established by the Financial Reporting Council (FRC) in 2010 is a prominent example, providing a comprehensive voluntary framework for institutional investors to engage with companies on governance and sustainability issues. The code emphasizes transparency, accountability, and the integration of ESG considerations into investment processes. UK Stewardship Reporting Reviews are conducted regularly to assess the implementation of the code and identify best practices. These reviews provide insights into how effectively investors are adhering to the code's principles, highlight areas for improvement, and ensure that the stewardship framework remains relevant and impactful in promoting sustainable investment practices. By continually evolving through these reviews, the UK Stewardship Code ensures that it remains at the forefront of credible stewardship practices.

Many other national-level stewardship codes exist and have been developed either by industry or governments.

- Japan’s Stewardship Code, developed by the Japanese Financial Services Agency in 2014 and revised in 2017 and 2020, targets institutional investors such as asset managers and pension funds, and is grounded in a principles-based approach.
- Similarly, the Singapore Stewardship Principles 2.0, introduced by the industry-led Stewardship Asia Centre with the support of MAS and SGX in 2016 and updated in 2022, guide institutional investors, including asset owners and managers, and are also voluntary.
- The Brazilian Stewardship Code, created by AMEC in 2016, supports sustainable investment practices for institutional investors and asset managers in Brazil.
- In Switzerland, the Asset Management Association Switzerland and Swiss Sustainable Finance launched the Swiss Stewardship Code in 2023, aiming at institutional investors and promoting voluntary adherence.
- The Dutch Stewardship Code, established by Eumedion in 2018, encourages responsible investment and engagement by institutional investors in the Netherlands.
- Hong Kong's Principles of Responsible Ownership, introduced by the Securities and Futures Commission in 2016, promote active ownership for investors in Hong Kong-listed companies and are voluntary.

- The Investor Stewardship Group (ISG) Stewardship Framework, a US-based initiative launched in 2017 by a coalition of institutional investors and asset managers, sets best practices for investor stewardship on a voluntary basis.
- The Australian Financial Services Council's Principles of Internal Governance and Asset Stewardship, developed in 2017, guide responsible investment for asset managers and institutional investors in Australia.
- The European Fund and Asset Management Association (EFAMA) introduced its Stewardship Code in 2018 based on principles-based best practice stewardship recommendations for European asset managers and institutional investors.

All these codes share a common voluntary approach and aim to foster long-term value creation and sustainability through active and responsible investment practices. Due to their voluntary nature, enforcement is mostly driven by market forces, reputational concerns, and peer pressure. Signatories are generally expected to regularly report on their stewardship activities after committing. Non-compliance typically results in reputational risks rather than legal penalties.

In the EU, some stewardship and engagement aspects are already embedded in regulation. The EU Shareholder Rights Directive II (SRD II) aims to promote long-term shareholder engagement and enhance corporate governance within EU-listed companies. It strengthens shareholder rights and transparency between companies and their investors by requiring institutional investors and asset managers to disclose their engagement policies and report annually on their implementation. It also foresees reporting on how certain asset owners embed long-term considerations into mandates of asset managers. SRD II introduces a "say on pay" mechanism, allowing shareholders to vote on executive remuneration policies to align compensation with long-term performance. The SRD II relies on a “comply or explain” approach that mandates explanations in case of non-compliance and thus also exposes firms to public scrutiny and potential reputational risks.

Additionally, several other regulatory instruments further support sustainable finance and stewardship in the EU. Fiduciary duty is a core principle underpinning these regulations, requiring asset managers and advisors to act in the best interests of their clients, which includes respecting and aligning with their sustainability preferences. The regulation on sustainability-related disclosures in the financial services sector (SFDR) requires financial market participants to disclose how outside-in sustainability risks are integrated into their investment processes and quantify principal adverse impacts of all their investments, i.e. inside-out impact of their investments on sustainability factors. Under investment and insurance rules on sustainability preferences laid down in MiFID II and IDD, advisors need to inquire about clients’ sustainability preferences and ensure that these are considered in investment advice, empowering clients to benefit from a closer alignment between investment products and his/her values. Furthermore, various requirements clarify fiduciary duties by requiring asset managers and insurance undertakings to assess outside-in sustainability risks, and also integrate inside-out principal adverse impacts.[5] These rules also mandate that financial product manufacturers integrate sustainability factors into the design and distribution of financial products. By doing so, they ensure that these products not only meet regulatory standards but also align with the sustainability preferences of clients,

[5] I.e. amending Delegated Acts, which specify detailed rules for implementing broader EU regulations. See also https://finance.ec.europa.eu/publications/sustainable-finance-package_en.

promoting transparency and accountability. In the case of SFDR, IDD, MiFID II and other sector-specific rules, a failure to comply can lead to fines, reputational damage, or exclusion from certain market opportunities.

In France, the implementing decree of Article 29 of the Energy Climate Law requires financial institutions to publish information on their engagement strategy with respect to investee companies and its implementation

### 2.2 Stewardship and Engagement as a Pillars of Net Zero Alliances

Stewardship and engagement are critical components of frameworks developed by net zero alliances, all of which are also voluntary and also rely on peer pressure, reputational concerns, public scrutiny and the threat of alliance exclusions to encourage compliance. The Glasgow Financial Alliance for Net Zero (GFANZ)[6] and the Net Zero Investment Framework (NZIF)[7] emphasize the importance of active engagement in transition planning and in driving the shift to a low-carbon economy. These frameworks provide guidelines for investors to engage with high-emitting companies and encourage them to adopt net zero strategies. For instance, the NZIF aims to ensure that the highest emitters are actively engaged, with the target that 70 percent of Scope 1, 2, and 3 financed emissions are either engaged or aligned or aligning with net-zero pathways. The threshold is due to increase to 90 percent by 2030.

The Institutional Investors Group on Climate Change (IIGCC), a European-focused membership organization, also integrates engagement into its Net Zero Stewardship Toolkit[8], offering resources and tools for investors to engage with companies on climate-related issues and align their portfolios with net zero goals.

### 2.3 Investor-Led Networks of Collaborative Engagement

Collaborative engagement initiatives bring together multiple investors to collectively influence companies and amplify the impact of their stewardship activities. Collaborative engagement initiatives are essential to bundle and scale the impact of individual investors, enabling them to collectively address systemic ESG challenges and drive meaningful change in corporate behavior.

Climate Action 100+ is a leading example, involving over 700 investors located in 33 jurisdictions, many of which are IPSF members. This initiative focuses on engaging the world's largest corporate greenhouse gas emitters to improve their climate-related disclosures, set emission reduction targets consistent with the Paris Agreement, and enhance governance on climate issues. According to several CA100+ members, "conducting climate engagements collaboratively, in keeping with all regulatory and legal requirements, enables greater efficiency and effectiveness in managing risks for investors of varying size and across different geographies".

Some collaborative investor networks are targeting specific sectors, such as FAIRR (Farm Animal Investment Risk & Return). FAIRR is an investor initiative that engages with global food companies and supply chain stakeholders to address ESG risks related to intensive animal

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[6] Recommendations-and-Guidance-on-Financial-Institution-Net-zero-Transition-Plans-November-2022.pdf (bbhub.io)
[7] Net_Zero_Investment_Framework_final.pdf (parisalignedassetowners.org)
[8] IIGCC Net Zero Stewardship Toolkit.pdf (hubspotusercontent-eu1.net)

agriculture. Addressing sector-specific sustainability issues is crucial as different industries face unique challenges and opportunities related to sustainability. Through collaborative engagement, FAIRR encourages companies to adopt sustainable practices and improve transparency on issues such as antibiotic use, deforestation, and greenhouse gas emissions associated with livestock production.

Climate Engagement Canada (CEC) is also an example of a regional initiative where investors work together to influence corporate behaviour, focusing on enhancing climate-related disclosures and promoting sustainable practices in the Canadian market.

These networks provide frameworks and tools to support collaborative engagement efforts. For instance, Climate Action 100+ offers the Net Zero Company Benchmark, which assesses companies' progress towards net zero targets, and detailed sectoral guidance to help investors engage effectively. Similarly, the IIGCC's Net Zero Stewardship Toolkit provides resources for investors to integrate climate considerations into their stewardship practices.

### 2.4 Civil Society Supportive Tools and Instruments

Civil society organizations offer a range of tools and instruments to support and inform stewardship efforts. These tools are crucial to enhance transparency and accountability in investment practices, helping financial institutions assess the effectiveness of their engagement strategies and identify areas for improvement. They provide valuable data and analysis, enabling investors to make informed decisions and enhance their engagement efforts. Notable examples include:

- Carbon Tracker, that analyzes the financial risks associated with climate change and provides insights into the carbon exposure of companies.
- InfluenceMap, that evaluates the climate-related lobbying activities of corporations and their alignment with climate goals.
- FinanceMap, that assesses the climate performance of financial institutions and their portfolios.
- LobbyMap, that tracks corporate lobbying activities and their impact on climate policies.

These initiatives have also started feeding their data and insights into broader transition finance tools that intend to consolidate data and analysis all in one place, such as TransitionArc. TransitionArc has developed an easy-to-use public interface that allows to view the sustainability performance of individual firms or sectors, based on data provided by leading players in the sustainability field (e.g. SBTi, TPI, WBA, CDP, InfluenceMap, etc.). Policy engagement is a key dimension of the tool that can greatly help many stakeholders, including investors, companies, governments and civil society, assess ambition and track progress over time.

### 2.5 Other Supportive Elements

Effective stewardship and engagement are supported by various additional elements, including disclosures, transition plans, and assurance mechanisms. These aspects are increasingly being taken on by regulators in the context of disclosure mandates. Comprehensive, transparent and comparable disclosures, as well as data quality, reliability and accessibility are critical for investors to assess the sustainability performance of companies and engage effectively[9]. In addition, transition plans outline the strategies companies will adopt to achieve net zero emissions, providing a roadmap for investors to monitor and support their progress. By mandating more granular and comparable data on companies' sustainability practices and corporate governance, transparency and accountability are enhanced, enabling investors to better assess company performance and engage more effectively on sustainability issues. This detailed reporting helps investors adapt their stewardship activities depending on the progress made by companies, ultimately fostering more informed engagement and stewardship practices.

In addition, assurance mechanisms, such as third-party verification and certification, can help ensure the credibility and reliability of companies' sustainability claims and disclosures. These mechanisms help build trust and confidence among investors, enhancing the effectiveness of stewardship and engagement activities.

[9] E.g. see the IMF-WB-OECD critical considerations with respect to the concrete implementation of alignment approaches: Activating Alignment: Applying the G-20 Principles for Sustainable Finance Alignment with a Focus on Climate Change Mitigation, July 2023 (imf.org)

## 3. Key Common Elements

Based on an analysis of the initiatives provided above, this section examines eleven key elements that are common to most of these frameworks and that thus can be seen as constituting a baseline with respect to stewardship and engagement.

**Fig. 2: Overview of the key common elements**

| Key Common Elements |
|---|
| 1. Policy Definition |
| 2. Identification of Risks and Opportunities |
| 3. Governance and Processes |
| 4. Voting |
| 5. Engagement Strategies and Processes |
| 6. Escalation Procedure |
| 7. Monitoring |
| 8. Delegation to Service Providers |
| 9. Conflicts of Interest |
| 10. Transparency and Reporting |
| 11. Public Policy Advocacy |

**Policy Definition**
Stewardship and engagement initiatives commonly start with the establishment of robust policies that guide the behavior and decisions of institutional investors. These policies often emphasize engagement and voting practices that are consistent with science-based paths to net-zero emissions and other consensus-based frameworks. Investors are encouragd to identify and prioritize companies based on criteria such as those outlined in ShareAction's RISE (Responsible Investment Standards and Expectations) escalation guidance paper[10] or the Institutional Investors Group on Climate Change (IIGCC) guidelines. These policies are designed to ensure that investments are directed towards companies that are both materially significant and exhibit a potential for improvement. Developing a comprehensive strategy that includes setting criteria for company selection and prioritization is essential for effective stewardship.

**Inclusion of a Risk-Based Approach and Proactive Identification of Opportunities**
Modern stewardship codes emphasize a risk-based approach to investment, ensuring that risks are identified, assessed, and managed proactively. This approach not only mitigates potential downsides but also involves the proactive identification of opportunities that can enhance long-term value creation. A risk-based approach often includes focusing on key themes for selected companies, such as their decarbonisation strategies, capital allocation

[10] RISE-paper-2.pdf (assets-servd.host)

towards sustainable projects, medium-term sustainability targets, and climate policy engagement.

**Governance and Processes**

Effective stewardship requires strong corporate governance[11] and well-defined processes. Institutional investors are encouraged to allocate appropriate resources, including sufficient staffing and the necessary research and analytical capabilities, to support informed stewardship decision-making. This involves ensuring that the team responsible for stewardship has the expertise and capacity to conduct thorough evaluations and engage effectively with investee companies.

**Voting**

Voting is a critical tool with respect to engagement. Stewardship codes typically mandate that investors exercise their voting rights responsibly to influence corporate behavior. This includes voting on important resolutions related to ESG issues at annual general meetings (AGMs). Investors may also pre-declare their voting intentions to signal their stance and encourage corporate transparency and accountability.

Recent trends show a decline in the number of votes in favor of climate change proposals, reflecting a potential shift in investor priorities or increased scrutiny over the specifics of these proposals. Moreover, there are notable challenges related to the types of resolutions that can be put to a vote. In certain jurisdictions, companies may have the discretion to omit shareholder resolutions from the AGM agenda, especially those related to climate or social issues. This has led to increased litigation, with some shareholders taking legal action to ensure their climate-related proposals are not excluded. Additionally, the rise of virtual AGMs, which became more prevalent during the COVID-19 pandemic, has introduced new dynamics in shareholder engagement. While virtual meetings provide broader access, there is a debate about their possible use to limit meaningful interaction and discussion, potentially disincentivizing robust shareholder engagement and voting on critical issues.

Furthermore, some recent trends include twin track stewardship offerings, with asset managers providing different stewardship services tailored to the diverse ESG preferences of their clients. Also, as part of their voting strategy, it is possible that asset managers engage in split voting, where different votes are cast on the same resolution for different clients. This practice, while developed to respect the diverse preferences of clients, can lead to inconsistencies and potential conflicts of interest, eventually undermining the effectiveness of stewardship commitments.

**Engagement Strategies and Processes**

Beyond voting, direct engagement with investee companies is a fundamental element of stewardship. Engagement can be carried out in various ways, from private meetings and dialogue with company management to public statements and collaborations with other investors. Collaborative engagements with other investors are also used to amplify the impact and effectiveness of stewardship activities. Techniques such as pre-declaring voting intentions ahead of AGMs, or even reducing the size of investments to signal discontent, are employed to exert pressure on companies to improve their practices.

[11] E.g. based on the G20/OECD Principles of Corporate Governance or other best practice principles and guidelines.

**Escalation Procedure**

A well-defined escalation procedure is vital for stewardship efforts to be credible and effective. This typically involves a clear timeline and stages of engagement, starting with initial dialogues and progressing to more assertive actions if a company fails to respond adequately. These actions can include voting against board appointments or increases in executive remuneration. The ultimate step in an escalation procedure is often the exclusion of the company from the investment portfolio, serving as a powerful deterrent against non-compliance with expectations.

**Monitoring**

Ongoing monitoring of investee companies is crucial to ensure that they continue to meet the expectations set out by stewardship policies. This involves regular reviews of companies' progress towards meeting sustainability goals. Continuous monitoring helps investors identify any deviations from agreed-upon practices and enables timely interventions.

**Delegation to Service Providers**

Institutional investors often delegate certain stewardship activities to specialized service providers. These providers offer expertise in areas such as proxy voting, sustainability research, and engagement strategies. Effective stewardship codes outline the responsibilities of these service providers and ensure that their actions align with the overarching stewardship policy of the investor.

**Conflicts of Interest**

Addressing conflicts of interest is a key component of effective stewardship. Codes typically require investors to establish clear policies to identify, manage, and disclose any conflicts that may arise. This ensures that stewardship activities are conducted in the best interests of beneficiaries and stakeholders, maintaining the integrity of the engagement process.

**Transparency and Reporting**

Transparency is a cornerstone of modern stewardship practices. Investors are expected to report on their stewardship activities, providing detailed accounts of their engagement efforts, voting records, and the outcomes achieved. Regular reporting enhances accountability and allows beneficiaries and other stakeholders to assess the effectiveness of the stewardship strategy.

**Public Policy Advocacy**

Many stewardship initiatives also include elements of public policy advocacy. By engaging with policymakers and participating in public consultations, investors can influence the regulatory environment to support sustainable investment practices. This advocacy helps to create a broader context in which responsible investment can flourish, contributing to systemic change at a macro level.

## 4. Key Elements towards Best Practice

The review of several frameworks and practices has revealed some potentially useful aspects that are not yet mainstream across all frameworks. Better integrating these best practices into evolving stewardship frameworks and practices could significantly enhance their effectiveness. This section thus discusses these key best practice elements that should be considered when refining engagement frameworks. They will be structured according to the key elements of stewardship used in the previous section. In addition, the section highlights a few additional enabling policy-related elements that can further bolster stewardship frameworks and their impact in the longer-term.

**Fig. 3: Key elements towards best practice**

| Key Best Practice Elements |
|---|
| 1. Policy Definition<br>➢ Greater asset class coverage<br>➢ Outcome and effectiveness focus |
| 2. Identification of Risks and Opportunities |
| 3. Governance and Processes<br>➢ Executive approval and internal culture |
| 4. Voting<br>➢ Beyond climate resolutions<br>➢ Following through on voting<br>➢ Addressing split voting |
| 5. Engagement Strategies and Processes<br>➢ SMART engagement<br>➢ Platforms of collaborative engagement<br>➢ Measuring engagement success |
| 6. Escalation Procedure<br>➢ Greater standardization and structure |
| 7. Monitoring<br>➢ Beyond voting: capital allocation and investment decisions |
| 8. Delegation to Service Providers<br>➢ Stewardship Value Chain Guidance, Standards and Reviews |
| 9. Conflicts of Interest |
| 10. Transparency and Reporting<br>➢ Reporting templates<br>➢ Timeliness and quality of disclosures<br>➢ Sectoral expectations and short-term actions |
| 11. Public Policy Advocacy |
| Further Policy Elements<br>➢ Feedback mechanisms and regular updates<br>➢ Legal framework and investor education |

**Policy Definition**

***Greater Asset Class Coverage.*** Effective stewardship policies increasingly cover a broad range of asset classes beyond equity, including bonds and sovereign debt[12]. This expanded focus allows investors to exert influence at critical points, such as primary issuance or refinancing, thereby promoting sustainable practices across a wider spectrum of financial markets. Leveraging influence during bond issuances and rollovers is important to ensure that sustainability considerations are integral to the financing process. Financial institutions could also consider how to best harmonize their engagement policies and practices across their investment, lending, capital market, underwriting and client engagement activities to ensure institution-wide consistent approaches.

***Outcome and Effectiveness Focus.*** Stewardship strategies that prioritize outcomes and effectiveness over mere process adherence are more impactful. This involves not only implementing policies but also focusing on the quality of engagements rather than ticking boxes. Real-world case studies and concrete examples of successful outcomes can illustrate the tangible benefits of effective stewardship. With the caveat that changes in investee company behavior might not always be directly attributable to engagement activities, measuring and reporting the results of actual engagements to the greatest extent possible can help demonstrate the value of stewardship efforts and encourage continuous improvement.

**Governance and Processes**

***Executive Approval and Internal Culture.*** Robust governance processes include the approval of stewardship reports at the executive level, ensuring alignment with organizational values and culture. Executive and board oversight reinforces the importance of stewardship within the organization and promotes a top-down commitment to responsible investment practices. It ensures accountability and integration into the institution's overall strategy. Cultivating an internal culture that values sustainability principles, enhances the effectiveness of stewardship efforts and aligns them with the broader mission of the institution.

**Voting**

***Beyond Climate Resolutions.*** Voting practices should extend beyond climate resolutions to include broader governance and sustainability issues, including nature and social aspects where relevant.

***Following through on voting.*** The credibility of stewardship is highly dependent on proving that voting practices truly reflect the chosen stewardship strategy and that voting is effective in disciplining investee companies. Transparency about voting intentions, timely disclosure of voting records, and justifications for voting decisions enhance credibility, accountability and trust. This level of transparency fosters accountability and enables civil society and investee companies to understand the rationale behind voting actions. Such transparency is also key to help investors and the broader public track and understand potential inconsistencies, between the stated stewardship strategy and votes in favor of non-aligned AGM resolutions

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[12] With respect to sovereign debt, the NGFS has recently published a technical document on Considering climate-related risks and transition impact in the sovereign investments of central banks that might also be useful to financial institutions more broadly.

for instance, thus ensuring that stewardship strategies do not remain empty high-level declarations of intent. In addition, voting out directors who fail to address important sustainability concerns helps ensure that stewardship strategies are taken seriously by investee companies[13].

***Addressing Split Voting.*** As part of refining voting strategies, it is important for asset managers to consider the implications of split voting and maintain credibility and effectiveness of stewardship.

**Engagement strategies and processes**

***SMART Engagement.*** Engagement strategies should be SMART (Specific, Measurable, Attainable, Relevant, Time-bound), focusing on alignment[14] with transition plans and improved disclosures. Effective engagement occurs at both the executive and technical levels, ensuring that discussions are comprehensive and actionable. Setting clear and achievable engagement objectives ensures focused and impactful interactions with investee companies.

***Platforms of collaborative Engagement.*** Collaborative engagement, facilitated through platforms such as the PRI Collaboration Platform[15], can amplify the impact of individual investors by pooling resources while avoiding antitrust issues. Collaborative engagement can also help draw on collective experience with respect to the most effective ways to engage with specific companies, thus allowing the design of more impactful engagement strategies that are tailored to the firm-specific context[16]. Furthermore, streamlining the filing of shareholder climate resolutions and promoting coordinated actions can enhance the collective influence on corporate practices.

***Measuring Engagement Success.*** Developing metrics to assess the success of engagement activities is vital, as is being realistic and frank about the extent to which engagement activities are directly linked with positive changes. These metrics should capture both the progress of engagements and the ultimate outcomes, enabling investors to assess the effectiveness of their strategies and refine their approaches over time.

**Escalation Procedure**

***Towards greater Standardization and Structure.*** Standardized structured escalation frameworks based on best practice, such as the one proposed by ShareAction in its RISE (Responsible Investment Standards and Expectations) guidance paper[17], provides a clear, time-bound pathway for escalating issues. Reporting on both successful and failed escalation outcomes ensures transparency and accountability, highlighting the importance of a disciplined and transparent escalation process. A structured escalation process reinforces accountability and signals the seriousness of stewardship commitments and strong

[13] Papers.ssrn.com/sol3/papers.cfm?abstract_id=3612928
[14] For more concrete implementation recommendations, see for e.g. Activating Alignment: Applying the G-20 Principles for Sustainable Finance Alignment with a Focus on Climate Change Mitigation, July 2023 (imf.org)
[15] https://collaborate.unpri.org/
[16] City Research Online - Tailor-to-Target: Configuring Collaborative Shareholder Engagements on Climate Change
[17] RISE-paper-2.pdf (assets-servd.host)

governance. Clear and consistent communication with investee companies throughout the escalation process is essential to ensure understanding and compliance.

**Monitoring**

***Beyond Voting: Capital Allocation and Investment Decisions.*** Monitoring should extend beyond voting activities to include capital allocation, investment decisions, and stewardship at the portfolio and system levels. This comprehensive approach ensures that all aspects of the investment process are aligned with the engagement objectives. Periodic reviews of monitoring processes ensure they remain relevant and effective in achieving stewardship goals. Using technology, data analytics and data platforms can enhance the efficiency and effectiveness of monitoring processes.

**Delegation to Service Providers**

***Stewardship Value Chain Guidance, Standards and Reviews.*** Guidance should encompass the entire stewardship value chain, including investment consultants, proxy advisors, and other service providers. Establishing a code of conduct or minimum standards for proxy advisors, alongside capacity-building initiatives, enhances the effectiveness and integrity of outsourced stewardship activities. Rigorous due diligence in selecting service providers ensures alignment with the investor's stewardship objectives. Regular performance assessments of service providers ensure they continue to meet the investor's stewardship expectations.

**Transparency and Reporting**

***Reporting Templates.*** Developing templates that incorporate best practices can help increase the consistency, completeness and effectiveness of individual stewardship strategies. Examples include the widely adopted template for engagement reporting developed by the Investment Consultants Sustainability Working Group (ICSWG)[18] or the Best Practice Engagement Reporting Template[19] by ShareAction that provides definitions and guidance beyond ICSWG. In addition, the UK FCA has convened an industry-led Vote Reporting Group[20] that is looking to design a comprehensive and standardized vote reporting framework that would help enhance comparability. Standardised reporting templates facilitate comparability and consistency in stewardship disclosures, enhancing overall transparency.

***Timeliness and Quality of Disclosures.*** Timely disclosures of voting intentions, concrete stewardship activities, and the resources allocated to these efforts are essential for transparency. Adopting "comply or explain" approaches or mandatory minimum disclosure requirements, publishing reports on websites in machine-readable formats using digital taxonomies, and including executive-level approval will be essential to enhance decision-useful transparency.

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[18] https://www.icswg-uk.org/_files/ugd/b25a61_fcbd76f46bce4d989a46e25ea7fd873a.xlsx?dn=ICSWG%20Engagement%20Reporting%20Guide_2023.xlsx
[19] ShareAction_CA100_2022_ANNEX.pdf (assets-servd.host)
[20] Vote Reporting Group | FCA

***Sectoral Expectations and Short-Term Actions.*** Publishing sectoral expectations and including short-term actions to avoid procrastination or a lack of ambition is critical for setting clear and actionable stewardship goals. Benchmarking against industry standards complements measurement efforts and provides a basis for continuous improvement.

**Further Enabling Policy Elements**

***Feedback Mechanisms and Regular Updates.*** Effective stewardship frameworks include feedback mechanisms between companies and investors, regular updates, and reviews of guidelines. Providing feedback on individual submissions, such as through the UK Stewardship Reporting Reviews of the Financial Reporting Council (FRC), and incorporating assurance processes ensure that stewardship practices remain relevant and effective.

***Legal Framework and Investor Education.*** More regulators could consider explicitly mandating disclosures on stewardship and engagement strategies and their implementation to strengthen credibility and accountability. In addition, supportive legal framework that allows shareholders to bring issues to AGMs without resolutions, as seen in the UK Green Agreements Guidance[21] or the EC's Horizontal Guidelines[22], clarifies that collaborative engagement does not breach competition law. Additionally, ongoing investor education and capacity-building initiatives are essential to broaden the understanding and implementation of best practices in stewardship. To support informed decision-making and align investment strategies with sustainability goals, tools like the sustainability preferences under MiFID II ensure that investment products meet the sustainability preferences of clients, further integrating sustainability into investment advice and portfolio management.

By incorporating these best practice elements, institutional investors can develop robust stewardship strategies and frameworks that drive meaningful and sustainable change. These practices ensure that investors not only address immediate sustainability risks but also capitalize on opportunities to promote long-term value creation and systemic sustainability.

[21] Green agreements guidance (publishing.service.gov.uk)
[22] Communication from the Commission – Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements (europa.eu)

## 5. Conclusion and Recommendations

Effective stewardship is a key element of transition finance and transition planning. In fact, several regulators and net zero alliances expect stewardship and engagement strategies to be an integral element of transition planning, transition plans and broader sustainable finance disclosures. By fostering sustainable practices and encouraging companies to adopt strategies aligned with a low-carbon economy, stewardship plays a crucial role in driving the transition and ensuring long-term value creation.

The review of existing guidance documents and frameworks on stewardship and engagement has shown that they broadly include a core set of basic components. These usually cover policy definition, the identification of risks and opportunities, governance and processes, voting, engagement strategies and processes, escalation procedures, monitoring, delegation to service providers, transparency, as well as public policy advocacy.

In a second step, the paper has attempted to distill key best practice elements that have yet to be mainstreamed across frameworks but have been highlighted as keys to the effectiveness of stewardship and engagement strategies. Key considerations and recommendations for further improvement can be summarized as follows:

First, enhancing the comprehensiveness and effectiveness of stewardship strategies is crucial. This means expanding coverage to include a broader range of assets (not only equities but also other asset classes including bonds), a variety of voting items, and mainstreaming active ownership strategies across all investment and capital allocation decisions. In addition, voting out directors who fail to address important sustainability concerns helps ensure that stewardship strategies are effective in changing investee company behavior.

Second, ensuring comparable, structured, and timely transparency on stewardship strategies, implementation, and outcomes is vital. This can involve developing or using templates that reflect current best practices. Ideally, such strategies should be integrated and mainstreamed into transition plans.

Third, embedding continuous improvement into stewardship frameworks is essential. This can be achieved through regular review and feedback mechanisms, which help refine existing frameworks and maximize their impact.

Finally, supportive policy frameworks play a significant role in facilitating effective stewardship. Transparency and disclosures are critical, both to mainstream disclosures on engagement strategies and implementation, and to improve the data quality, availability and comparability that market participants need to shape effective stewardship strategies. In addition, the removal of hurdles that might prevent financial market participants from engaging in collaborative efforts can also help strengthen stewardship impact. A conducive environment ensures that stewardship activities are conducted efficiently and effectively, contributing to the broader goals of transition finance.