ROBECO
The Investment Engineers

ACTIVE OWNERSHIP REPORT

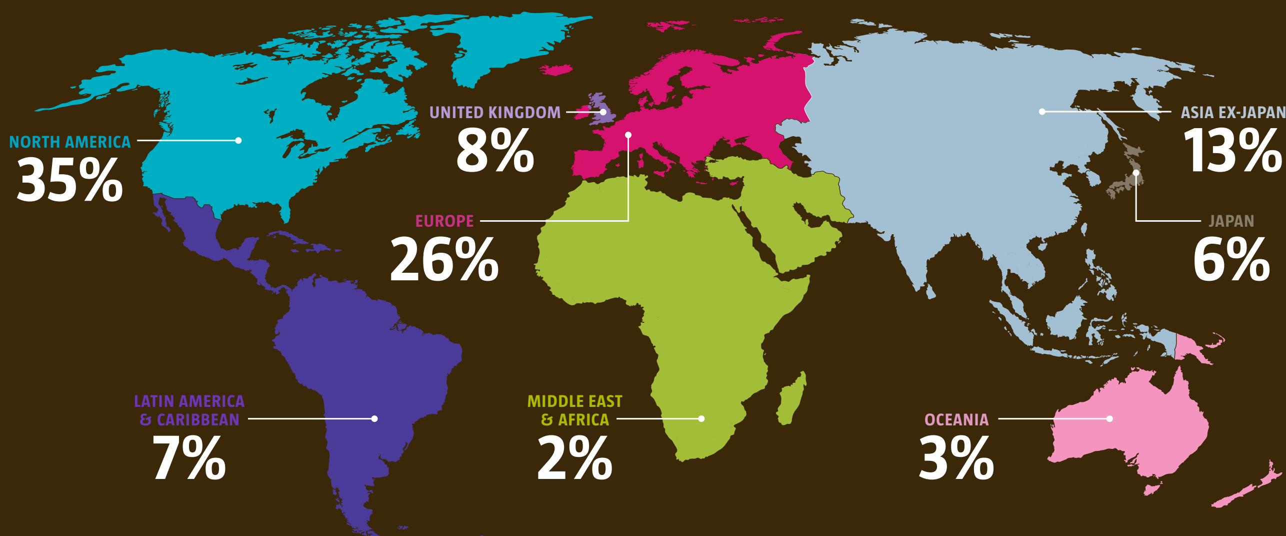
ROBECO | 01.10.2021 - 31.12.2021

Q4
2021

Sustainable Investing Expertise by
ROBECOSAM

Q4|21 FIGURES ENGAGEMENT

Engagement activities by region



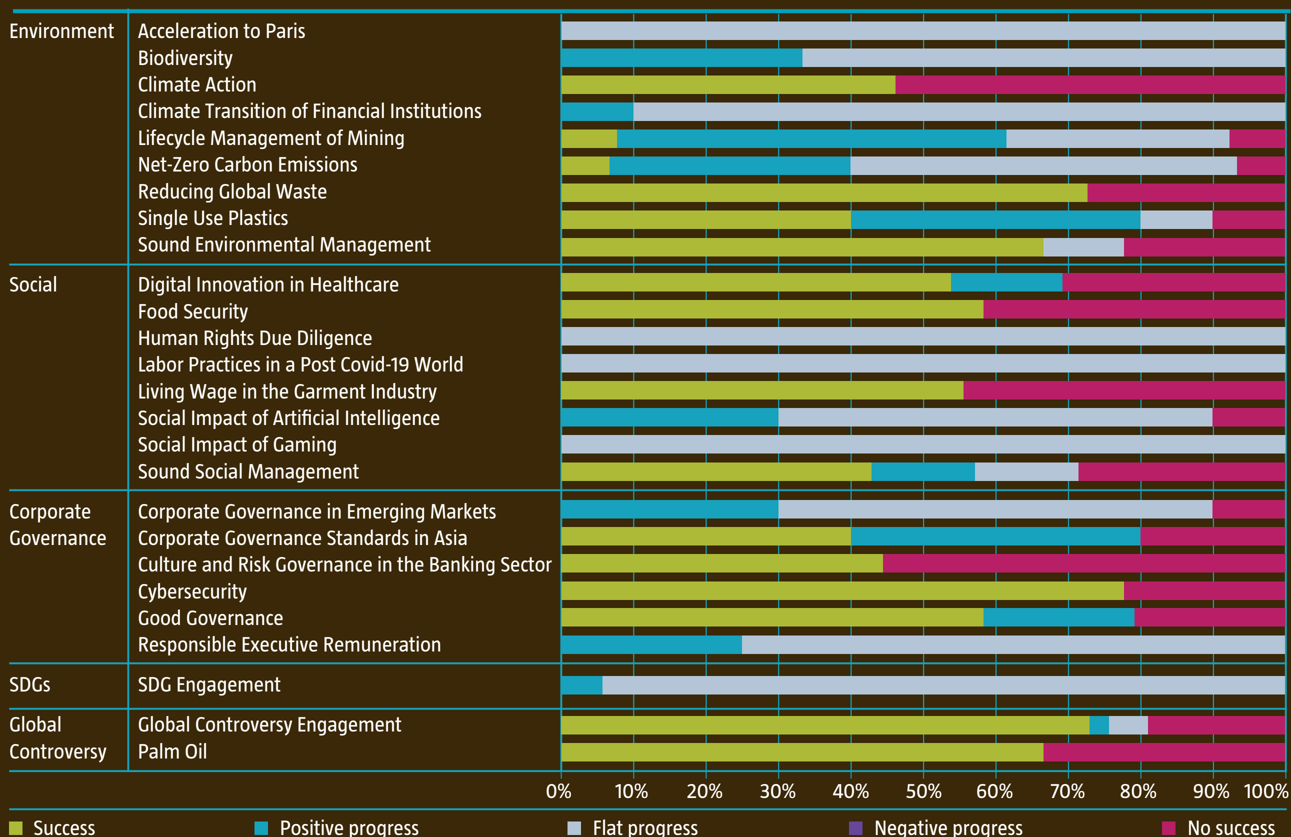
Number of engagement cases by topic

	Q1	Q2	Q3	Q4	YTD
Environment	55	47	30	51	79
Social	32	52	31	55	76
Corporate Governance	27	35	18	39	52
SDGs	-	-	16	29	35
Global Controversy	5	11	9	20	28
Total	119	145	104	194	270

Number of engagement activities per contact type

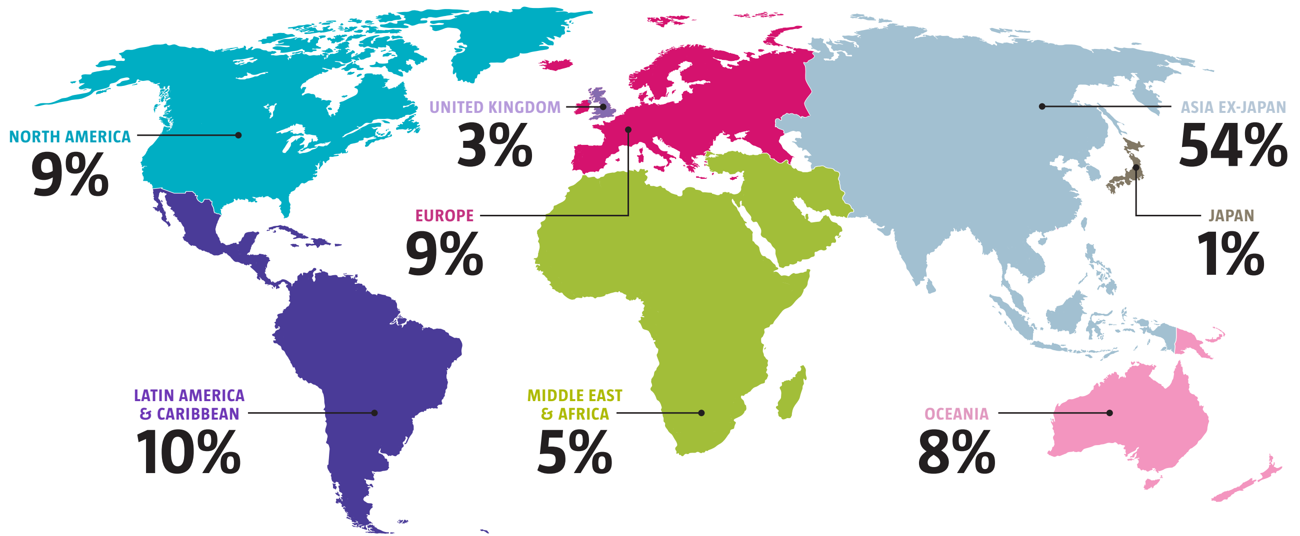
	Q1	Q2	Q3	Q4	YTD
Meeting	-	3	-	1	4
Conference call	97	99	67	130	393
Written correspondence	82	100	68	152	402
Shareholder resolution	2	1	-	1	4
Analysis	31	25	13	47	116
Other	2	17	2	2	23
Total	214	245	150	333	942

Progress per theme



Q4|21 FIGURES VOTING

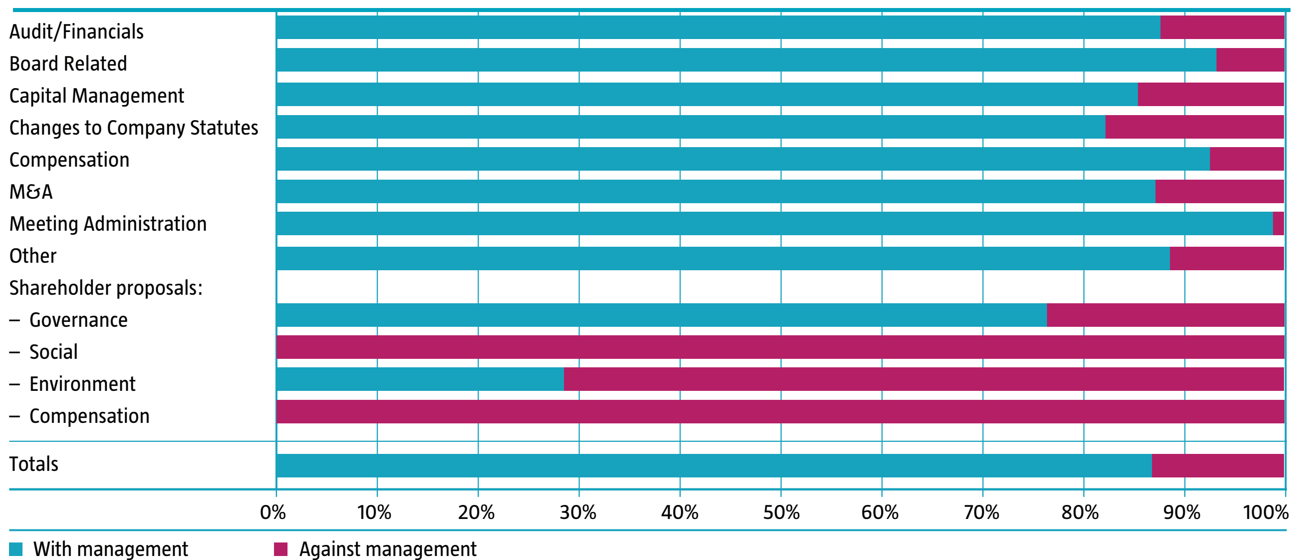
Shareholder meetings voted by region



Voting overview

	Q1	Q2	Q3	Q4	YTD
Total number of meetings voted	1.112	4.486	1.050	1.075	7.723
Total number of agenda items voted	9.645	54.932	7.813	6.339	78.729
% Meetings with at least one vote against management	54%	57%	44%	32%	51%

Votes cast per proposal category



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INTRODUCTION

Over the last quarter of 2021, we saw a strong collective effort to protect our climate and biodiversity, not only at Robeco but across the world. Companies and governments set new, ambitious goals to reduce their environmental impact during the 26th UN Climate Change Conference (COP26) held in November. Leading up to COP26, Robeco launched its Net Zero roadmap, paving the way to decarbonizing all its assets under management by 2050. Engagement lies at the core of our climate change strategy, reflecting the importance that we attribute to active ownership.

Despite recently expanded commitments, doubts remain whether companies are equipped to sufficiently limit global warming. In our new 'Acceleration to Paris' engagement theme, Robeco focuses on the climate laggards and largest emitters within our investment universe in order to help them ramp up their decarbonization efforts. In light of the urgency of taking action, failure to make progress can be regarded as a breach of global standards, with escalation or even exclusion as potential consequence.

Besides the growing importance that we attach to climate change, we want to stop to reflect on some of our ongoing and concluding engagements. On the social front, we have closed our engagement efforts tackling the payment of living wages across the garment supply chain, an industry in which poverty pay levels and strong power inequalities are common. During the engagement, we followed fashion brands as they took concrete action to address the issue, from integrating living wage definitions into their policies and adopting responsible purchasing practices, to offering transparent grievance mechanisms across their supply chains.

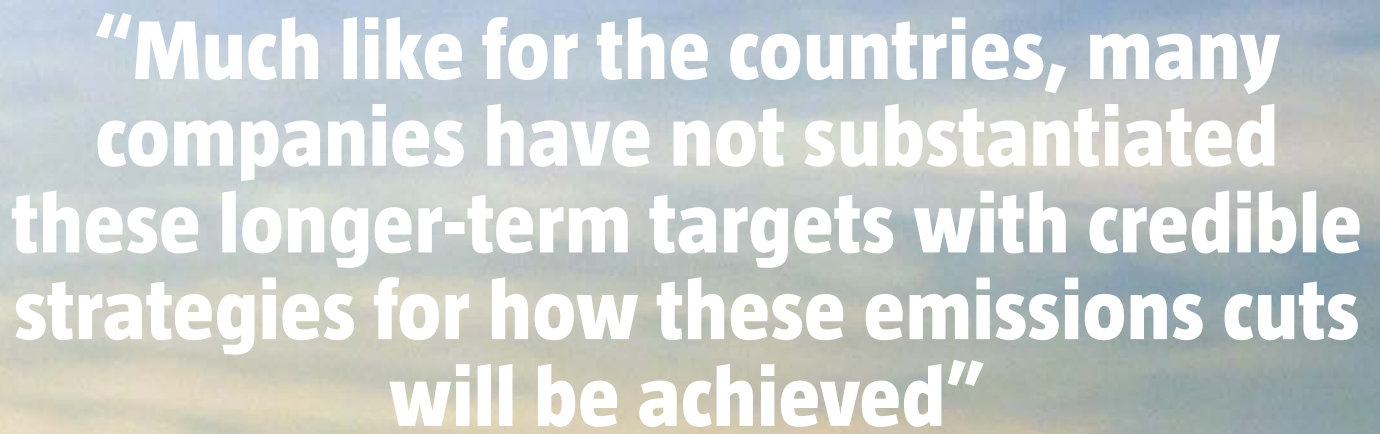
Meanwhile, on the governance side, we concluded our engagement with the financial sector around culture and risk governance. Financial institutions are exposed to numerous governance-related risks, some reaching as far as money laundering or other financial crimes. Thus, carefully drafted incentive and remuneration policies, in-depth processes around non-financial crimes and strong risk governance are key to building a strong financial sector. Through the engagement, we for instance were able to push for more balanced employee and executive remuneration schemes and learned about the importance of corporate culture in defining risk governance.

While we believe that companies can do much to improve their corporate governance, regulatory action is also required to foster systematic change. We provide an update on our policy engagement with stock exchanges, financial regulators, and related stakeholders across emerging markets, during which we provide them with feedback on their corporate governance standards. This report offers insights into our ongoing dialogue with the Korean Corporate Governance Service, reflecting on South Korea's corporate governance codes and the country's enhanced approach towards environmental and social accountability.

Lastly, we have also updated our enhanced engagement program, focusing on companies involved in severe and structural breaches of the United Nations Global Compact (UNGC) or the OECD Guidelines for Multinational Enterprises. We have strengthened the oversight and decision-making process, with a robust underlying dataset aligned with the UNGC and OECD guidelines and with the establishment of a new Controversial Behavior Committee. This renewed process and enhanced engagements with companies will be led by a dedicated Controversy Engagement Specialist we recently onboarded.

As we move into the new year, we are encouraged by the global movement that is putting environmental and social issues at the forefront of their actions.

Carola van Lamoen
Head of Sustainable Investing



ACCELERATION TO PARIS

INTERVIEW WITH NICK SPOONER – *Engagement Specialist*

This quarter we launch Robeco’s new ‘Acceleration to Paris’ engagement theme, recognizing the accelerated action needed to achieve the goals of the Paris agreement. We have analyzed 200 of the largest emitters across our investment universe on their climate-risk and selected the 13 worst performers to enter our climate-focused enhanced engagement program. In this Q&A, Nick Spooner explains Robeco’s refined climate engagement approach and reflects on past successes.

What changes do you see in the policy landscape that have the potential to impact corporate climate commitments?

The 26th UN Climate Change Conference (COP26) has now concluded and there is much to reflect on. While the level of ambition has certainly increased, as governments made more specific pledges and targets to cut emissions to combat global warming, there is still a long way to go. Many countries have yet to set out explicit plans for how they will decarbonize their economies by 45% over the next eight years, consistent with the recommendations of the Intergovernmental Panel on Climate Change (IPCC). One overarching outcome from the conference was the success of the ratcheting mechanism, with many countries coming forward with new net zero targets, and others increasing the level of ambition of their existing targets. This has been enabled by a shared sense of responsibility and the risk that some countries could fall behind and face enhanced policy risks such as carbon border adjustment mechanisms which would negatively impact their export markets.

Are companies reacting to policy changes and implementing net zero strategies?

What is true for countries is true for companies. In the private sector, there has been a rapid increase in the number of net zero targets, with 52% of Climate Action 100+ companies now setting one. However, much like for the countries, many of these companies have not substantiated these longer-term targets with credible strategies for how these emissions cuts will be achieved.

There is also a large set of companies that have yet to set greenhouse gas emission reduction targets or a net zero target. It is these companies that face the most significant transition risks; a lack of targets and policies is likely to act as a proxy for the mismanagement of climate-related risks and opportunities.

How does Robeco plan to address this through the climate engagement program?

Our Acceleration to Paris engagement program focuses on these laggards. A number of companies were identified as the largest emitters within Robeco's investment universe. We used a proprietary system that leverages third-party data sources such as the Climate Action 100+ Net Zero Benchmark to assess the top 200 emitters in the universe.

'WE EXPECT THAT SETTING BOUNDARIES TO THE ENGAGEMENT AND ULTIMATUMS FOR THE COMPANIES IN THEIR PROGRESS INCREASES THE PRESSURE ON THEM AND ALSO CREATES GREATER ACCOUNTABILITY AROUND THE ENGAGEMENT PROCESS.'

NICK SPOONER

In addition to looking at key indicators around climate risk management, we included an additional layer that identifies companies which continue to expand thermal coal power infrastructure, which we deem to be incompatible with the Paris Agreement. Through this analysis, we are able to categorize companies based on their performance and target the worst-performing companies. Each of the companies in the program will be receiving a letter outlining our expectations in managing climate-related risks. Those included within the Acceleration to Paris program will receive a tailored letter to initiate our engagement with them.

For 42% of the companies we assessed, there was insufficient data to accurately score them. This highlights a broader systemic issue related to the insufficient disclosure of material climate information and the need for enhanced regulations mandating the disclosure of climate-related financial risks.

How were companies selected for the program and what is the expectation of them in the engagement strategy?

Of the companies that we were able to fully assess, the 13 that ranked lowest were selected for enhanced engagement. These companies show the lowest level of awareness to climate-related risks and opportunities, creating material risks for investors from the energy transition. As these companies are relative laggards, there is already a proven pathway for them to improve and fall into line with the average sectoral performance.

Something that we also hope to achieve is to promote best practices in managing climate-related risks and opportunities that will create a spill-over effect across sectors and regions. We hope this will enhance the systemic impact of the engagement program.

So, by taking a focused approach to engagement, we aim to improve the relative performance of these companies and contribute to the reduction in real-economy emissions. This is also a core component of Robeco's Net Zero strategy, which targets an average annual emissions reduction from our investments of 7% per year. Our goal is to maximize the amount of emissions that are reduced within our investments through engagement with companies to lower their absolute level of emissions, along with the emissions' intensity.

What happens if there is insufficient progress in the engagement?

In recognition of the urgency of the climate crisis, and the short time left to reduce emissions by 45% by 2030, we have created the Acceleration to Paris program to drive rapid changes in corporate behaviors. The engagement program is designed to last for four years, though we will review its progress at regular intervals to assess whether companies have taken sufficient steps to manage climate-related risks and opportunities.

Should any company be making insufficient progress, they will be put forward to the Controversial Behavior Committee for selective divestment. We expect that setting boundaries to the engagement and ultimatums for the companies in their progress increases the pressure on them and also creates greater accountability around the engagement process.

We will track progress through company-level indicators, engagement indicators and outcomes, and ultimately establish ways to effectively track changes in the real economy. Our traffic light assessment methodology will evolve over the course of the program to establish a more accurate tracking process that enables benchmarking and reporting of progress on an annual basis.

What other actions will be taken to escalate the engagement?

Prior to any decisions around divestment, we will deploy other escalation tactics to advance the engagement. This includes, but is not limited to, voting against management on certain annual meeting agenda items, filing shareholder resolutions, and seeking to elect new board directors who are more willing to make the necessary changes.

We will also be working collaboratively with other shareholders as a 'strength in numbers' collective effort has often proven to be more powerful in effecting change. As the methodology for selecting companies has focused on the largest emitters, there is a significant overlap with the Climate Action 100+ initiative (CA100+), which offers an opportunity for collaboration through this forum. Each of these options will be used on a case-by-case basis depending on the perceived benefit.

How will this build on current climate engagements?

The Acceleration to Paris theme is the third pillar of our broader climate engagement program, the other two being the themes Net Zero Carbon Emissions and Climate Transition of Financial Institutions. The Net Zero Carbon Emissions theme launched in 2020 has seen successful outcomes during Q4 2021, two of which are:

Enel commits to full decarbonization by 2040

Throughout 2021, Robeco has been engaging with Enel with a particular focus on setting long-term targets for its scope 3 emissions from natural gas sales to customers, which represent 23% of total emissions, and a decarbonization strategy for its natural gas generation activities. At its Capital Markets Day on 24 November, Enel committed to fully decarbonizing by 2040, bringing forward its previous net zero target by a decade. In order to meet this target, Enel has committed to generate and sell energy exclusively from renewable sources. The company aims to reach 154 GW of capacity in renewables by 2030, which if achieved would make it the largest renewables operator in the world based on peers' current targets.

The target to reduce scope 3 emissions from Enel's natural gas retail business was an explicit request that Robeco made earlier this year as the investor leading the engagement under the CA100+ initiative. Enel's announcement is therefore a huge step forward and places the company in a genuine leadership position as it transitions to a low-carbon business model.

WEC Energy commits to setting targets on scope 3 emissions

Robeco has been engaging with WEC Energy as a member of CA100+. The coalition identified a significant gap in the company's climate strategy as it lacks targets to reduce scope 3 emissions from the sale of natural gas to customers which represent 50% of total emissions.

After engaging through 2021 without seeing significant progress, CA100+ escalated the dialogue by threatening to file a shareholder resolution. In response, in November 2021 WEC Energy committed to setting targets on scope 3 emissions in 2022. In addition, WEC will produce a progress report prior to the 2023 annual shareholder meeting, issuing annual progress reports thereafter, that disclose goals and strategies relative to Scope 3 emissions from the natural gas distribution business.

Fashion victim: Tackling poverty pay in the apparel sector

LIVING WAGE IN THE GARMENT INDUSTRY

LAURA BOSCH – *Engagement specialist*

This quarter, we concluded our engagement theme focused on advancing the payment of living wages across the global apparel supply chain. While around half of the engagement dialogues were closed successfully, we recognize that structural changes in the industry are needed to systematically advance the payment of living wages across the board.

'IF THERE WAS EVER A TIME FOR WORKING TOWARDS A PAYMENT OF LIVING WAGES, IT IS NOW.'

LAURA BOSCH

The poverty rate has reached almost 10% of the global population due to the impact of Covid-19, pushing over 100 million workers into poverty worldwide, and increasing the proportion of the so-called 'working poor'. Poverty pay is one of the most pressing issues for workers worldwide, and it is systemically embedded in the global garment and sportswear industries. Workers' wages represent only a fraction of what consumers pay for their clothes because of deep-rooted structural power dynamics. Governments have kept minimum wages low in a bid to create jobs and boost their economies. As a result, a minimum wage – where it exists as a legally binding standard – is far from sufficient to provide for workers and their families' basic needs. Therefore, paying a living wage is instrumental in the battle against poverty reduction across the globe.

Engagement focus

In 2019, we launched an engagement program focused on advancing the payment of living wages in the global supply chain of the apparel industry. We carried this out through the Platform Living Wage Financials (PLWF), a coalition of 18 financial institutions, using their influence and leverage to engage with their investee companies on this topic. We engaged with nine companies in the industry, ranging from fast fashion retailers to luxury brands. The program focused on how companies uphold the payment of living wages across their strategy; how this is supported by responsible purchasing practices and meaningful industry collaborations; and whether they offered remedies when incidents were identified. After three years of engagement, we have seen some positive progress in the sector which has enabled us to successfully close around half of the cases.

Stepping stones towards living wages

While brands are laying out more comprehensive strategies on labor practices across their supply chain, there is still limited evidence of living wages actually being paid in sourcing countries. Over time, most of the companies under engagement have adopted references to living wages across their policies, yet only a handful lay out a strategic plan on how to accelerate the payment of living wages in their supply chain. Without a robust corporate ambition to close the gap between actual wages and living wage estimates, it is challenging to allocate sufficient corporate resources towards this goal.

We have noted progress in the companies' efforts to collect data on the wage levels paid across their supply chains, and to compare those against living wage benchmarks. Although few companies disclose the figures and findings from these assessments, we recognize that conducting this wage gap analysis does represent a significant step forward. These insights allow brands to clearly identify where wide wage gaps are located, enabling them to factor in this information in their decision-making process, such as in sourcing strategies and purchasing practices.

Living wages for workers can be achieved through sector-wide collaborations promoting collective bargaining at the industry level, and by adopting responsible purchasing practices. Several companies in our engagement program showcased positive progress in these two areas, yet there are limited disclosures on how these initiatives contribute to driving wage improvements on the ground. For instance, most brands participate in multi-stakeholder initiatives promoting decent work across their supply chains. However, few brands take ownership of these partnerships by disclosing their outcomes, and whether they contributed to closing the wage gap.

Looking forward

While the payment of living wages will remain on corporates' agenda for the years to come, there are other pressing issues haunting the industry in the midterm. China is the world's largest producer of yarn, textiles and apparel, as well as the second-largest producer of cotton worldwide, with a significant degree of vertical supply chain integration. Allegations of forced labor involving minority communities in the Chinese region of Xinjiang have exposed the supply chains of apparel companies to these risks. We will continue our engagement with apparel companies in our newly launched 'Enhanced Human Rights Due Diligence' engagement theme, focusing on companies' sourcing strategies and efforts to prevent human rights violations in their supply chains.

Regulation is a key piece of the puzzle when it comes to getting fashion companies to take responsibility for global labor issues. The expected EU mandatory environmental and human rights due diligence legislation will steer companies towards respecting and adhering to human rights. Though living wages will not be an explicit reporting element, accurate due diligence will naturally allow for it to be assessed as a salient risk. This legislation is expected to include liability and enforcement mechanisms, as well as access to remedy provisions for victims of corporate abuse.

Lastly, financial institutions will soon have to comply with the EU Taxonomy, which obliges investors to perform due diligence and ESG analysis on their investment portfolios. In addition, the 'do no significant harm' checks will need to be performed for all investments to ensure that companies are not contributing negatively to sustainability topics, including a lack of robust human rights due diligence and forced labor risks. While waiting for global legislative breakthroughs, it must be made clear to brands, governments and all other stakeholders that there is no time to sit back and wait. If there was ever a time for working towards a payment of living wages, it is now. ■

CASE STUDY

Adidas has integrated living wages into its purchasing practices by using a standard minute value costing system. This enables the sportswear apparel company to monitor wages paid by suppliers, along with the material, labor and overhead costs necessary to produce Adidas's products. Moreover, the company actively engages with its suppliers to improve social dialogue. Factories representing 85% of the company's sourcing volume are unionized and 56% of them have specific collective bargaining agreements in place. When it comes to providing remedy to workers, the company's human rights grievance channel, which is accessible to stakeholders across the supply chain, has set a precedent in the industry. On an annual basis, the company publicly reports the status of complaints on the Adidas Human Rights webpage, indicating the region and the types of organizations that have reported the complaints.

Banking on governance

CULTURE AND RISK GOVERNANCE IN THE BANKING SECTOR

MICHIEL VAN ESCH – *Engagement specialist*

This quarter, we are concluding Robeco's engagement project on the quality of risk management and governance in the financial industry, which we started in 2017. Since the global financial crisis, many banks have been forced to redesign their approach to risk management, compliance and incentive structures. Even after the crisis, many banks continued to be faced with governance-related issues, such as sanctions violations, money laundering issues, and other financial crimes.

Our engagement project aimed to address these issues by firstly analyzing the quality of governance on a set of issues, and secondly (where possible) to seek improvements. Four topics were made a priority: incentives for risk-taking personnel; remuneration policies for executives; processes around non-financial crimes; and the quality of risk governance.

Incentive structures: towards a balanced approach that serves all stakeholders

Incentives have been an area of focus for many financial institutions in recent years. One clear example where incentives went wrong were the mis-selling schemes uncovered at Wells Fargo a few years ago. Employees across the firm had structurally opened accounts for customers without their consent. A key driver for these mishaps was the incentive structure of the bank. Employees were encouraged to focus on selling as many products (i.e., cross-selling) as possible for individual clients. And it was not only Wells Fargo that experienced unintended consequences from its incentive structures – it was common at other banks as well.

As a result, many banks have now moved their incentive structures away from meeting sales targets towards a more balanced approach. In recent years, performance evaluation schemes and KPIs for variable pay have changed. Many banks have incorporated so-called scorecards that evaluate employees on a set of metrics including client care, risk management, teamwork and other KPIs rather than only looking at sales targets. In some cases, banks have stripped variable pay altogether, or drastically lowered the amount of bonus pay to avoid so-called perverse incentives.

Executive remuneration: how to appropriately account for risk?

Another aspect closely related to the incentives of employees is the behavior of the executive management. Therefore, we also closely looked at whether the risk appetite of top management was appropriately aligned with prudent risk management and the interests of investors more broadly. We carefully evaluated the remuneration practices of several banks and the processes they had set up for key risk takers, including executives. Option structures that specifically allowed for upside potential are clear red flags, as these can trigger excessive risk-taking behavior.

We noted that companies increasingly consider risk as an important part of their executive remuneration policies. This happens, for example, by limiting payouts above specific return thresholds, or by requiring certain solvency requirements as a requirement for variable pay to begin with. We noted that pay practices differ widely between markets, with many European banks taking a more conservative approach to variable pay for executives than their American counterparts.

Non-financial risks are as material as ever

Non-financial risks are those that don’t directly relate to financial developments such as interest rate rises or falls, or changes in the economic environment. They deal with risks linked to regulation, operational incidents, and a wide range of risks stemming from the behavior of employees. Risks linked to financial crimes in particular have come to the fore in recent years. Several banks have been fined heavily for having insufficient controls in place in relation to money laundering. Many banks have subsequently allocated an increasing part of their resources to detect money laundering by implementing Know Your Client (KYC) procedures and by improving the monitoring of suspicious transactions. However, the issue remains difficult to solve, as criminals involved in money laundering use multiple banks for their activities, while monitoring at individual banks can at best capture just one piece of the puzzle. Therefore, initiatives are being developed in several regions for banks to share practices and information with each other.

Risk governance – is it process or culture?

Our final objective related to risk oversight. Even though it may sound straightforward, this is probably the most difficult metrics to measure as an outsider to any financial institution. Some of our expectations dealt with observable qualities, such as whether there was sufficient risk expertise on the board of directors, whether the bank had an adequate risk appetite framework, and whether the risk and compliance functions were set up so that they can operate independently. However, a binary ‘yes or no’ answer to these questions only provides a partial picture of a more complex oversight system. Even if some of these best practices are met, it is no guarantee that oversight is being performed adequately.

Over the course of our engagement, we have seen banks that had met such best practices still ran into problems with regulatory requirements. The reality is that large banks run a variety of financial services across many different jurisdictions with a variety of different regulations which are continuously changing.

‘THE RELEVANT QUESTION IS HOW BANKS CAN QUICKLY ADDRESS EMERGING ISSUES, PUT NEW PROCESSES IN PLACE, AND ESCALATE THREATS APPROPRIATELY.’

MICHIEL VAN ESCH

Therefore, all banks will have at least some degree of regulatory and compliance issues. The relevant question is how banks can quickly address emerging issues, put new processes in place, and escalate threats appropriately.

Banks that ran into severe issues often told us that in the end there was no culture of escalation, or that risk reporting was not sufficiently to the point. These issues can only partially be explained by looking at governance structures and procedures. The other relevant part is cultural and behavioral. Are boards digging deep into the quality of their risk and compliance procedures? Is management creating a culture that addresses risk instead of ignoring it? Discussing these questions with board members or management often gave us the best insights into risk management priorities and the most urgent challenges.

Looking back at the engagement

Looking back at four years of engagement in the financial sector, we note progress on some of our objectives. However, for most banks we still struggle to gain conviction on the quality of their risk management, and can only find external indicators for corporate culture. Therefore, we have been able to close our engagement with less than half of our peer group.

For the banks where the engagement was successfully closed, we were often able to verify that KPIs for executives contained relevant performance indicators in order to improve risk management and take a cautious approach towards risk. For many European banks, we were also able to get a better understanding of how key risk takers within the firm were rewarded, and what type of incentives applied for sales forces. In many instances, we were also able to verify that banks lived up to basic expectations on risk governance, including centralizing risk and compliance reporting, escalation procedures and the level of risk expertise on the supervisory board.

The most difficult objective proved to be the objective on operational risk management and understanding the quality of approaches to counteract money laundering. Even though many banks seem to follow the same processes, it remained hard to get a better understanding of the actual implementation of such processes. Even where banks are making steady progress to improve risk management towards trending risks such as financial crimes, new challenges and regulation put the financial sector in a dynamic in which new enhancements need to be made on a continuous basis. ■

Governance through governments

CORPORATE GOVERNANCE IN EMERGING MARKETS

RONNIE LIM – *Engagement specialist*

Our engagement program for emerging markets focusses on both policy and company engagement. Policy engagement provides opportunities to provide feedback to stock exchanges, financial regulators and related stakeholders on corporate governance standards, and these engagements may have a wider impact than corporate engagement alone.

We have approached several institutions in China, South Korea, Brazil and Hong Kong. The aim of our engagement is to provide better protection for minority shareholders and improve independent oversight on companies, but also to improve disclosure requirements, including ESG-related reporting. In the second half of 2021, we discussed the recent revision of South Korea's ESG codes together with the Korea Working Group at the Asian Corporate Governance Association.

There were some minor revisions in the ESG codes for corporate governance, but major changes to the environmental and social components. Following feedback from multiple stakeholders, the Korea Corporate Governance Service published its 'ESG Code of Best Practices – Revisions and Key Changes' in August 2021. South Korea now has a meaningful ESG code which is expected to be used by ESG ratings organizations and the country's Fair-Trade Commission, along with the principal Ministries of Justice, Environment and Social Justice, and by domestic companies.

The Code's revisions addressed major issues that were faced by the business community together with international investors' contributions to ESG guidelines. The Code's main characteristics are that it now reflects international norms having made significant changes to the global disclosure requirements for public companies.

The revisions to the Environmental Code have a renewed focus on risk management, emphasizing how companies should prepare and respond to environmental risks, the circular economy, green bonds and the impact of companies in supply chains. It also introduced governance concepts such as those recommended by the Task Force on Climate-Related Financial Disclosures.

The revisions to the Social Code emphasized governance by using the World Business Council on Sustainable Development Enterprise Risk Management Framework. The issues addressed are principally human rights, social responsibility in the supply chain (based on ISO 26000), consumer protection and the 2021 Korea Corporate Manslaughter Act.

The revisions to the Governance Code included key matters which the Korea Working Group has been engaging on, including the responsibilities of the board and its individual directors, ESG risks and succession planning. New emphasis was placed on the responsibilities of the boards of conglomerates to protect the interests of shareholders equally, and to manage potential conflicts of interest in related-party transactions. Other revisions include enhancing transparency with stakeholders on ESG, the appointment of independent directors on an audit committee, and remuneration policies.

A few areas of improvement could be the inclusion of metrics and targets in the Code, and that foreign investors be invited to make formal submissions to future revisions.

In conclusion, the revised code represents a significant improvement in the breadth and content of from the existing corporate ESG norms for South Korean companies, especially in the social and environmental dimensions. We are especially encouraged by the increased expectations for transparency and accountability for businesses, and that it is now largely the responsibility of investors to engage their portfolio companies to commit to tangible targets. ■

'POLICY ENGAGEMENT PROVIDES OPPORTUNITIES TO PROVIDE FEEDBACK TO STOCK EXCHANGES, FINANCIAL REGULATORS AND RELATED STAKEHOLDERS ON CORPORATE GOVERNANCE STANDARDS, AND THESE ENGAGEMENTS MAY HAVE A WIDER IMPACT THAN CORPORATE ENGAGEMENT ALONE.'

RONNIE LIM

Proxy voting

ANTONIS MANTSOKIS – *Active ownership analyst*
LUCAS VAN BEEK – *Active ownership analyst*

Active Ownership Analysts Antonis Mantsokis and Lucas van Beek reflect on some of the trends and sustainability questions that will continue to define the agenda for next year's proxy voting season. Among them are the increasingly important topic of aligning executive compensation with relevant ESG metrics, and new developments around corporate governance and stewardship led by the United Kingdom.

ESG & Compensation

Executive compensation has repeatedly been a topic of discussion among investors and companies. Shareholders, through voting and engagement, have an immense influence on executive remuneration matters, and are pushing companies to focus on long-term value creation and sustainable growth.

The trend we have seen over the recent years, is for investors to push companies to incorporate Environmental, Social, and Governance (ESG) metrics into their Short-term (STI) and Long-term (LTI) incentive plans. This trend is based on the idea that companies that promote sustainable business practices, and link executive pay to ESG metrics, are more likely to outperform those that do not. A study conducted by the Sustainable Insight Capital Management (SICM) and the Carbon Disclosure Project (CDP), showed that companies that are industry leaders with respect to climate, are generating superior profitability, cash flow stability and dividend growth for investors. But that hypothesis is not always confirmed, since there have been cases where shareholders experienced a significant hit due to ESG-related issues. The main challenge nowadays is for companies to determine the key sustainable metrics that are highly related to their sustainable business strategy, and how these should be linked to pay incentives.

One side of this challenge is that not all companies today are in a position to instantly change their business strategy and implement initiatives that are solely based on sustainable thinking. Nevertheless, executives and boards in those companies should recognize that sustainability will be one of the main drivers that will lead to a shift in the way their businesses operate over the next years. As such, they should find a way to implement small changes today while they work towards bolder transformations in the future. Compensation committees are too focused on trying to incorporate metrics in their remuneration schemes that are mostly related to mitigating ESG risk. Instead, they should aim to link executive bonuses to strategic opportunities related to sustainability that would create value. Metrics that reward executives' efforts to improve future performance by adopting sustainable practices, are welcomed by investors.

There is no one-size-fits-all solution on how to link executive compensation to sustainability and at the same time drive performance and successfully manage all stakeholders. That is why companies should look for those ESG metrics that are material for their industry. For example, a food company could link executive compensation to metrics that show the percentage revenue growth from the sales of healthy products. This metric would align executives with the societal goal of reducing junk food consumption to reduce dietary-related illnesses such as diabetes and obesity. A car manufacturer, on the other hand, might link compensation to the company's strategic shift to the sales of electric vehicles. Lastly, a financial services firm might reward its executives for successfully shifting the focus in capital allocation from fossil fuels, like coal, to sustainable projects and other sources of renewable energy.

Investors have increasingly supported the link of executive remuneration to sustainability. Over the last years many companies worldwide have adopted, based on their industry, ESG-related goals in their compensation packages. However, companies should clearly define those metrics that have a meaningful impact in their business strategy, by conducting a materiality assessment. The outcome of this assessment should be transparently disclosed, and the metrics used in the compensation scheme should have a measurable impact on stakeholders and a financial materiality for shareholders.

Addressing issues like climate change or social injustice might not have been the main priorities of management teams or supervisory boards a few years ago. However, the world we live in is rapidly changing, and as companies are part of our society, they need to find a way to address those issues too. Linking executives' pay to various sustainability metrics can be a useful tool and a good starting point that would help address multiple ESG opportunities and risks.

Market highlight – United Kingdom

The United Kingdom (UK) is known for being at the forefront of corporate governance and shareholder rights. Especially the Companies Act provides shareholders, even those with relatively small positions, various instruments to ensure they can voice their opinion and draw the attention of the board of directors. Through the strong facilitation of the right to ask questions, submit proposals or present statements during the general meeting of companies, equity investors can share their views and act as a driver for specific courses of corporate action. The legal and regulatory framework in the UK lays out a strong fundamental environment for shareholder activism, which has been on the rise globally. Moreover, the country offers particular fertile conditions for shareholder activism to flourish, as it is in the midst of structural change, organizing a post-Brexit economy, tackling a pandemic and mitigating climate change.

Besides shareholders that increasingly utilize their rights to drive sustainable change within corporations, the UK audit watchdog, the Financial Reporting Council (FRC), has also raised the bar when it comes to approving signatories to their updated Stewardship Code. This year we have seen over one third of applications, also

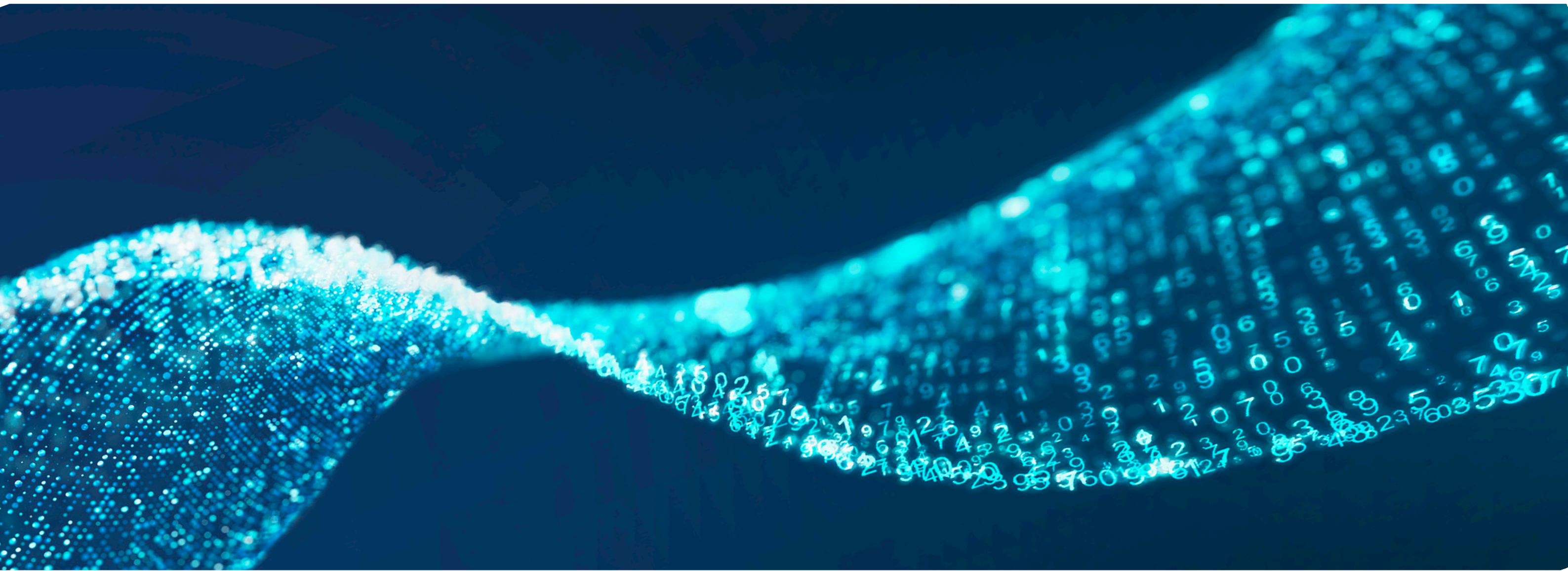
from some major institutional investors, be rejected after careful consideration.

Moreover, the FRC recently published its review of corporate governance reporting in which they discuss the quality of disclosures in the light of the UK Corporate Governance Code in 2021 and set out multiple expectations regarding companies' reporting practices for 2022. The review focused on reporting around compliance with the code, the impact and outcomes of engagements, remuneration, and diversity and succession planning. Generally, the FRC recommends companies to enhance disclosure around their review processes, the link between their policies and strategy and around their interactions with stakeholders, using clear and consistent explanations supported by real life examples.

As reporting is key for shareholders to assess a company's performance and impact on all types of material matters, we fully agree with and support the recommendations of the FRC. The need for improvement around the coherence between a company's succession planning, diversity policies and strategy is also brought to light by the Parker Review, another great UK example of corporate governance leadership. This initiative is designed to address and improve racial and ethnic diversity in organizations. The Parker Review not only recommends a target for FTSE100 companies to include at least one director of color as of January 1st 2022, it also takes a more holistic approach to diversity and inclusivity. For example, the Parker Review recommends companies to establish or revisit diversity and human capital policies in light of the corporate strategy and openly endorse the importance of diversity by leadership.

All in all, the UK certainly leads the direction of travel in terms of spirit and legislative developments regarding corporate governance and shareholder rights. As a responsible investor, we will continue to closely monitor all (legislative) developments in areas of investment stewardship and corporate governance, to make sure we align with best practices and remain at the forefront of the sustainability transition within the financial sector. ■

CODES OF CONDUCTS



Robeco's Engagement Policy

Robeco actively uses its ownership rights to engage with companies on behalf of our clients in a constructive manner. We believe improvements in sustainable corporate behavior can result in an improved risk return profile of our investments. Robeco engages with companies worldwide, in both our equity and credit portfolios. Robeco carries out two different types of corporate engagement with the companies in which we invest; value engagement and enhanced engagement. In both types of engagement, Robeco aims to improve a company's behavior on environmental, social and/or corporate governance (ESG) related issues with the aim of improving the long-term performance of the company and ultimately the quality of investments for our clients.

Robeco adopts a holistic approach to integrating sustainability. We view sustainability as a long-term driver of change in markets, countries and companies which impacts future performance. Based on this belief, sustainability is considered as one of the value drivers in our investment process, like the way we look at other drivers such as company financials or market momentum.

More information is available at: https://www.robeco.com/docm/docu-robeco-engagement-policy.pdf

The UN Global Compact

One of the principal codes of conduct in Robeco's engagement process is the United Nations Global Compact. The UN Global Compact supports companies and other social players worldwide in stimulating corporate social responsibility. The Global Compact became effective in 2000 and is the most endorsed code of conduct in this field. The Global Compact requires companies to embrace, support and adopt several core values within their own sphere of influence in the field of human rights, labor standards, the environment and anti-corruption measures. Ten universal principles have been identified to deal with the challenges of globalization.

Human rights

1. Companies should support and respect the protection of human rights as established at an international level
2. They should ensure that they are not complicit in human-rights abuses.

Labor standards

3. Companies should uphold the freedom of association and recognize the right to collective bargaining
4. Companies should abolish all forms of compulsory labor
5. Companies should abolish child labor
6. Companies should eliminate discrimination in employment.

Environment

7. Companies should adopt a prudent approach to environmental challenges
8. Companies should undertake initiatives to promote greater environmental responsibility
9. Companies should encourage the development and diffusion of environmentally friendly technologies.

Anti-corruption

10. Companies should work against all forms of corruption, including extortion and bribery.

More information can be found at: https://www.unglobalcompact.org/

CODES OF CONDUCTS

OECD Guidelines for Multinational Enterprises

The OECD Guidelines for Multinational Enterprises are recommendations addressed by governments to multinational enterprises operating in or from adhering countries, and are another important framework used in Robeco's engagement process. They provide non-binding principles and standards for responsible business conduct in a global context consistent with applicable laws and internationally recognized standards.

The Guidelines' recommendations express the shared values of the governments of countries from which a large share of international direct investment originates and which are home to many of the largest multinational enterprises. The Guidelines aim to promote positive contributions by enterprises to economic, environmental and social progress worldwide.

More information can be found at: http://mneguidelines.oecd.org/

International codes of conduct

Robeco has chosen to use broadly accepted external codes of conduct in order to assess the ESG responsibilities of the entities in which we invest. Robeco adheres to several independent and broadly accepted codes of conduct, statements and best practices and is a signatory to several of these codes. Next to the UN Global Compact, the most important codes, principles, and best practices for engagement followed by Robeco are:

- International Corporate Governance Network (ICGN) statement on
- Global Governance Principles
- United Nations Global Compact
- United Nations Sustainable Development Goals
- United Nations Guiding Principles on Business and Human Rights
- OECD Guidelines for Multinational Enterprises
- Responsible Business Conduct for Institutional Investors (OECD)

In addition to our own adherence to these codes, we also expect companies to follow these codes, principles, and best practices. In addition to our own adherence to these codes, we also expect companies to follow these codes, principles, and best practices.

Robeco's Voting Policy

Robeco encourages good governance and sustainable corporate practices, which contribute to long-term shareholder value creation. Proxy voting is part of Robeco's Active Ownership approach. Robeco has adopted written procedures reasonably designed to ensure that we vote proxies in the best interest of our clients. The Robeco policy on corporate governance relies on the internationally accepted set of principles of the International Corporate Governance Network (ICGN). By making active use of our voting rights, Robeco can, on behalf of our clients, encourage the companies concerned to increase the quality of the management of these companies and to improve their sustainability profile. We expect this to be beneficial in the long term for the development of shareholder value.

Collaboration

Where necessary, Robeco coordinates its engagement activities with other investors. Examples of this includes Eumedion; a platform for institutional investors in the field of corporate governance and the Carbon Disclosure Project, a partnership in the field of transparency on CO_2 emissions from companies, and the ICCR. Another important initiative to which Robeco is a signatory is the United Nations Principles for Responsible Investment. Within this context, institutional investors commit themselves to promoting responsible investment, both internally and externally.

Robeco's Active Ownership Team

Robeco's voting and engagement activities are carried out by a dedicated Active Ownership Team. This team was established as a centralized competence center in 2005. The team is based in Rotterdam, the Netherlands, and Hong Kong. As Robeco operates across markets on a global basis, the team is multi-national and multi-lingual. This diversity provides an understanding of the financial, legal and cultural environment in which the companies we engage with operate. The Active Ownership team is part of Robeco's Sustainable Investing Center of Expertise headed by Carola van Lamoen. The SI Center of Expertise combines our knowledge and experience on sustainability within the investment domain and drives SI leadership by delivering SI expertise and insights to our clients, our investment teams, the company and the broader market. Furthermore, the Active Ownership team gains input from investment professionals based in local offices of the Robeco around the world. Together with our global client base we are able leverage this network to achieve the maximum possible impact from our Active Ownership activities. ■

ROBECO

Robeco Institutional Asset Management B.V. (Robeco) is a pure play international asset manager founded in 1929. It currently has offices in 15 countries worldwide and is headquartered in Rotterdam, the Netherlands. Through its integration of fundamental, sustainability and quantitative research, Robeco is able to offer institutional and private investors a selection of active investment strategies, covering a range of asset classes.

Sustainability investing is integral to Robeco's overall strategy. We are convinced that integrating environmental, social and governance (ESG) factors results in better-informed investment decisions. Further we believe that our engagement with investee companies on financially material sustainability issues will have a positive impact on our investment results and on society.

More information can be found at: https://www.robeco.com

IMPORTANT INFORMATION

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