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The need for shareholder engagement on ESG issues

As the attention of boardrooms is increasingly drawn to climate risk and a hardening in the investor stance on environmental, social and governance (ESG) issues, the awareness of such risk is also broadening across industry sectors. It is not merely oil, gas and energy companies that face growing scrutiny, and the focus by investors and civil society is accelerating from the E issues to the S for the social issues highlighted by the joint experience of the pandemic over the last year. Working conditions, supply chains and the future of working habits are in the glare of the media spotlight as never before.

It has been an unprecedented year for ESG shareholder proposals at companies in the United States, with nearly three dozen majority votes for disclosure and action on resolutions.

Investors are translating their concerns on a perceived lack of action on climate risk by businesses in new ways, as Legal & General Investment Management (LGIM) demonstrated when it recently dropped AIG, the US insurer, from some of the funds in its £58 bn portfolio for having no policy on thermal coal or disclosure of emissions. Activist investor Engine Number One's win of three board seats at ExxonMobil was also made possible by the support of large investors.

Those investors are using what amounts to a carrot and stick approach with businesses across industry sectors when it comes to a broad range of issues, all of which sit under the ESG umbrella. LGIM also said that food retailer Kroger, the United States' largest supermarket by revenue, would be reinstated to a variety of funds because it had improved its deforestation policies and disclosures. Since

then, however, nearly half of Kroger shareholders have supported a proposal asking the company to reduce the amount of single use plastic in its operations, as reported by As You Sow, the non-profit shareholder advocacy firm.

Stewardship by investors around the climate risks posed but not addressed by businesses is concentrating focus at senior levels in sectors such as insurance. Insurers have been reported in the media as being aware of the issues. “The board is at the highest level of attention on this position”, Cristiano Borean, Group CFO at Generali, Italy’s biggest insurer, was quoted as saying recently to the Financial Times.

The latest signatories to the Net Zero Asset Managers Initiative mean that $57 trillion in assets, or over half of the asset management sector globally in terms of total funds managed, are committed to its net zero emissions target, heightening the need for corporate attention.

With a coalition of powerful investors now demanding that 1,320 companies make clearer disclosures about environmental risks, all aspects of the assessing and the reporting of risk, as well as how it is managed, will remain a hot topic on the boardroom agenda. Ahead of COP26, the campaign by the Carbon Disclosure Project (CDP) to build a coalition of investor support to demand data from businesses on their actions around climate change, deforestation and the use of water - and for it to be reported by business in a meaningful way - is working.

According to CDP, it has now attracted 168 asset managers at financial institutions across 28 countries, representing more than $17 trillion in combined assets. These are record levels of support, with a 56% increase since 2020 in the number of investors requesting corporate environmental disclosure. While the services sector predominates with over a fifth (21%) of the 1,320 contacted companies, four other industries are also well represented: manufacturing (17%), materials (12%), infrastructure (11%) and fossil fuels (6%).

The automotive industry is one where the valuation of companies based on where they are on the energy transition spectrum is seen as critical by investors keen to make the most of opportunities via scenario analysis on transition risk.

In the US, the regulatory debate is alive on whether to impose formal disclosure requirements for ESG metrics on US companies, with big tech companies such as Amazon and Facebook sending a letter to the SEC in June. “We believe that climate disclosures are critical to ensure that companies follow through on stated climate commitments and to track collective progress towards addressing global warming and building a prosperous, resilient zero-carbon economy,” the companies wrote.

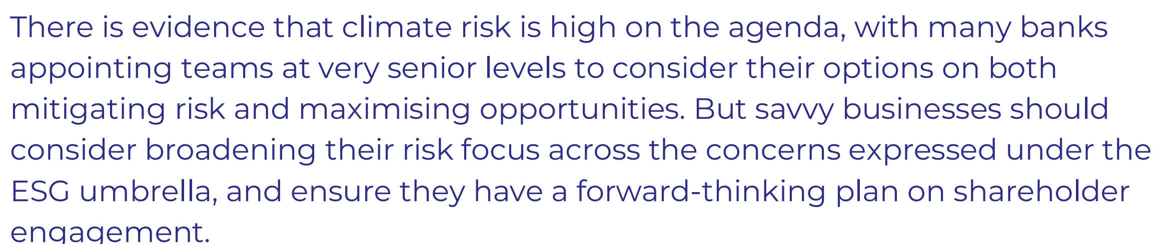
In Europe, the EU Regulation on ESG disclosure by certain financial services sector firms (the SFDR) was applied in March this year. The SFDR requires financial market participants and financial advisers to disclose certain ESG-

related information in relation to the provision of their services and the marketing of financial products.

Post Brexit, the UK is forging its own way around the standards set early in this rising awareness by the Financial Stability Board's Task Force for Climate-related Financial Disclosure (TCFD). All premium listed companies are obliged to include a statement in their annual financial report of whether their disclosures are consistent with FSB_TCFD recommendations and to provide an explanation if they are not, with more to come from the recently launched Financial Conduct Authority (FCA) consultation.

But it is not legislative and regulatory pressure alone that is shifting the dial. A letter sent to UK Prime Minister Boris Johnson in June saying that government proposals did not go far enough to ensure that the UK's environmental targets would be met had signatories which included more than 100 senior business leaders.

While the state of the ecosystem and the need for action on climate dominates the ESG media coverage, shareholders are also making their unease clear on other issues. More than twice as many FTSE 100 companies have faced a shareholder pay revolt this year than last year, as investors took a stance on remuneration within the broader context of the pandemic and economic hardship. Business models of gig economy businesses such as Uber and Deliveroo have come under fire for their treatment of workers.


On diversity and inclusion issues too, there are many signs of shareholder pressure. Boards need to be ready to demonstrate their awareness with data on their existing workforce, and the concrete steps they are taking that go well beyond awareness raising sessions around unconscious bias in recruitment and promotion. It is a sign of the times when a venture capital fund is launched which consciously looks for women and minority leaders in its first seven portfolio companies, putting impact and diversity at its core.

There is evidence that climate risk is high on the agenda, with many banks appointing teams at very senior levels to consider their options on both mitigating risk and maximising opportunities. But savvy businesses should consider broadening their risk focus across the concerns expressed under the ESG umbrella, and ensure they have a forward-thinking plan on shareholder engagement.