

# Introducing a standardised framework for escalating engagement with companies

Responsible Investment Standards & Expectations (RISE) – Guidance Paper #2

# About ShareAction

ShareAction is an NGO working globally to define the highest standards for responsible investment and drive change until these standards are adopted worldwide. We mobilise investors to take action to improve labour standards, tackle climate change and address pressing global health issues. Over 16 years, ShareAction has used its powerful toolkit of research, corporate campaigns, policy advocacy and public mobilisation to drive responsibility into the heart of mainstream investment. Our vision is a world where the financial system serves our planet and its people. .

Visit <https://shareaction.org/responsibleinvestment> or follow us on Twitter and Instagram @ShareAction to find out more.

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# Contact

[Investorengagement@shareaction.org](mailto:Investorengagement@shareaction.org)

# Authors

Niall Considine, Susanna Hudson,  
Danielle Vrubleviskis

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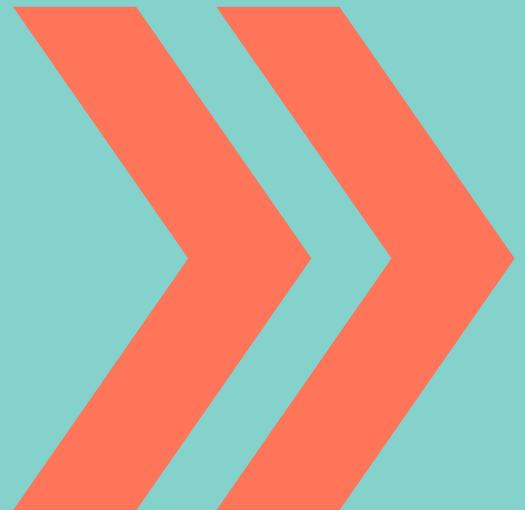
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# Background to RISE



# Background to RISE

Finance is critical to powering action to meet globally agreed climate targets and the Sustainable Development Goals (SDGs). Yet currently too little finance is being responsibly deployed, leading to a world where people face increased hardship due to inequality and the devastating impacts of climate change and nature loss. To ensure that finance is driving action to tackle social and environmental challenges at the scale and pace we desperately need, ShareAction is urging the investment community to align with its ambitious [new definition of responsible investment](#):

“Responsible investment is a transparent approach, embedded throughout the investment process, that takes the negative and positive impacts on people and planet as seriously as financial risk and return.”

ShareAction is supporting the investment community to meet this ambition by releasing a series of guidance papers that will set out **Responsible Investment Standards & Expectations (RISE)** for asset managers across specific topics. This guidance, grounded in detailed research, recommends actions that asset managers can – and should – take in today’s investment environment in pursuit of being a truly responsible investor. This guidance can also be used by asset owner clients, investment consultants and other stakeholders to inform their interaction with asset managers.

In this, the second guidance paper in the series, we address the topic of effective engagement through the use of escalation tools. These tools are critical to place the weight of consequence on investor dialogue with portfolio companies. This paper is supported by a more [detailed research note on escalation](#).

# Report Summary



# Report summary

ShareAction is introducing the concept of a standard **escalation framework** to facilitate the application of escalation tools with companies through corporate debt and listed equity.<sup>1</sup> The **escalation framework** comprises:

- The **escalation toolkit**, which groups different escalation tools into five categories of increasing strength;
- The **escalation pathway**, which sets out how the asset manager will apply and progress through the escalation toolkit in a timely manner.

We also include expectations on **resourcing** and **reporting** on the escalation framework.

## Benefits

Consistent disclosure and reporting around this escalation framework will:

1. Allow clients to assess and compare how asset managers are using escalation tools;
2. Provide transparency to companies so they can predict the effect their strategic choices will have on their relationship with investors and access to investors' capital;
3. Enable investors and stakeholders to identify overlapping goals and common purpose;
4. Encourage a more ambitious, consistent use of escalation tools to catalyse the necessary scale and speed of response to systemic environmental and social challenges.

## How to use this report

This report and its recommendations are designed to encourage the adoption of an escalation framework to encourage more consistent, time-bound and outcome-driven use of escalation tactics with portfolio companies. Reporting on the use of this framework would facilitate a richer assessment of engagement approaches and their effectiveness, and encourage more consistent and ambitious escalation by asset managers.

**Asset managers** should use this report and its expectations to:

- Understand how escalation tools can be categorised according to their strength;
- Understand how these tools can be applied in a transparent and structured way. This would enhance effective stewardship of clients' interests on environmental and social issues.

**Asset owners** and **investment consultants** can use this report and its expectations to shape standardised reporting that they ask of asset managers. Asset owners can also use this as part of their selection, appointment and monitoring process. This includes:

- The core environmental and social expectations that asset managers set for portfolio companies;
- How robustly asset managers hold portfolio companies to account against these expectations through the predictable deployment of the escalation toolkit.

Increasingly, asset owners are selectively engaging directly with portfolio companies. In such cases, we would welcome asset owners using our escalation framework in their engagements.

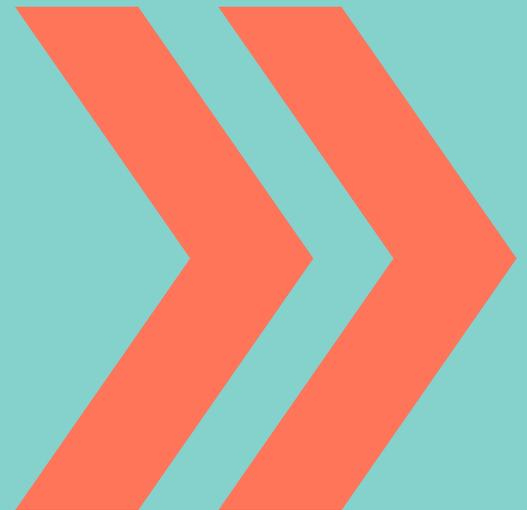
**Policy makers** can use this report and its expectations to develop and promote standardised reporting frameworks for asset managers' escalation and engagement activities.



## Glossary of terms used in this paper<sup>2</sup>

<p><b>Stewardship:</b> the UK Stewardship Code defines this as the “responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society”.<sup>3</sup></p>		
<p><b>Engagement:</b> the Financial Reporting Council (FRC) defines engagement as “proactive interactions aimed at accomplishing a specific objective with an issuer or group of issuers”.<sup>4</sup> ShareAction does not consider standard due diligence and monitoring activities (such as attending earnings calls, roadshows or regular meetings aimed at information gathering and relationship building) as engagement.</p>	<p><b>Collaborative engagement:</b> defined in the UK Stewardship Code as “collaboration with other investors to engage an issuer to achieve a specific change; or working as part of a coalition of wider stakeholders to engage on a thematic issue”.<sup>5</sup></p>	<p><b>Capital allocation:</b> the process of making, sizing and changing over time investments in companies or assets.</p>
<p><b>Escalation:</b> the intensification of engagement activities, following an insufficient response to concerns raised. ShareAction’s view is that escalating engagement involves the deployment of additional, more forceful actions, such as requisitioning shareholder proposals.</p>		

# Introduction



# Introduction

## Investors must engage to protect people and planet

The world today faces many systemic threats. Climate change is making dangerous heat waves and fires more common and intense. The biodiversity crisis threatens global food security. Deepening inequalities put social stability at risk, and people's health is compromised by poor diets, air quality and housing. These are serious dangers to both people and planet, and asset managers must act to mitigate them. This will also reduce the risk these threats present to the long-term interests of clients, which financial institutions are mandated to protect.

Asset managers (as agents) are entrusted with their clients' (as principals) capital and have a responsibility to invest and steward that capital in accordance with the interests – financial and non-financial – of those clients, and, ultimately, those clients' beneficiaries. Material environmental and social issues are encompassed by client interest, both because of the financial risks these issues pose to the long-term value of investments<sup>6</sup> and because many clients (and their beneficiaries) care about the adverse impacts their investments are having on the planet and its people.

The UN-supported Principles for Responsible Investment (PRI) articulates the broad scope of financial interest as follows: “overall value for clients and beneficiaries... includes the market value of the entire portfolio (as opposed to individual holdings or individual mandates); the long-term value-creation capabilities of firms and economies; and the common environmental, natural, intellectual, social, and institutional assets that underpin all economies”.<sup>7</sup> These “common assets” face various systemic threats broadly invested portfolios cannot diversify away from.

Even smaller or more concentrated asset managers should be concerned with, and robustly steward, systemic risks because of the potential for their effects to cascade across all or most parts of the economy.

The agent–principal relationship requires asset managers to apply their expertise on their clients' behalf. This expertise encompasses the ability to analyse and evaluate corporate risk and opportunity across sectors and geographies some way into the future. As well as being applied to investment decisions, this expertise can and should equally be applied to stewardship. This will complement the specific expertise of the company and encourage it onto a path that aligns with client interest and preference, including on environmental and social issues. This should not be conflated with “micro-managing”, as is sometimes suggested; rather it is the proper expression of expectation and guidance on issues of systemic or material importance.

## The importance of escalation

Escalation is critical, as it reduces the potential for engagement to become a “tea and biscuits” affair in which no consequence is attached to a company that fails to respond appropriately to investor concerns. Establishing a time-bound escalation framework and reporting on its use will facilitate client understanding of how effectively the asset manager is representing their interests.

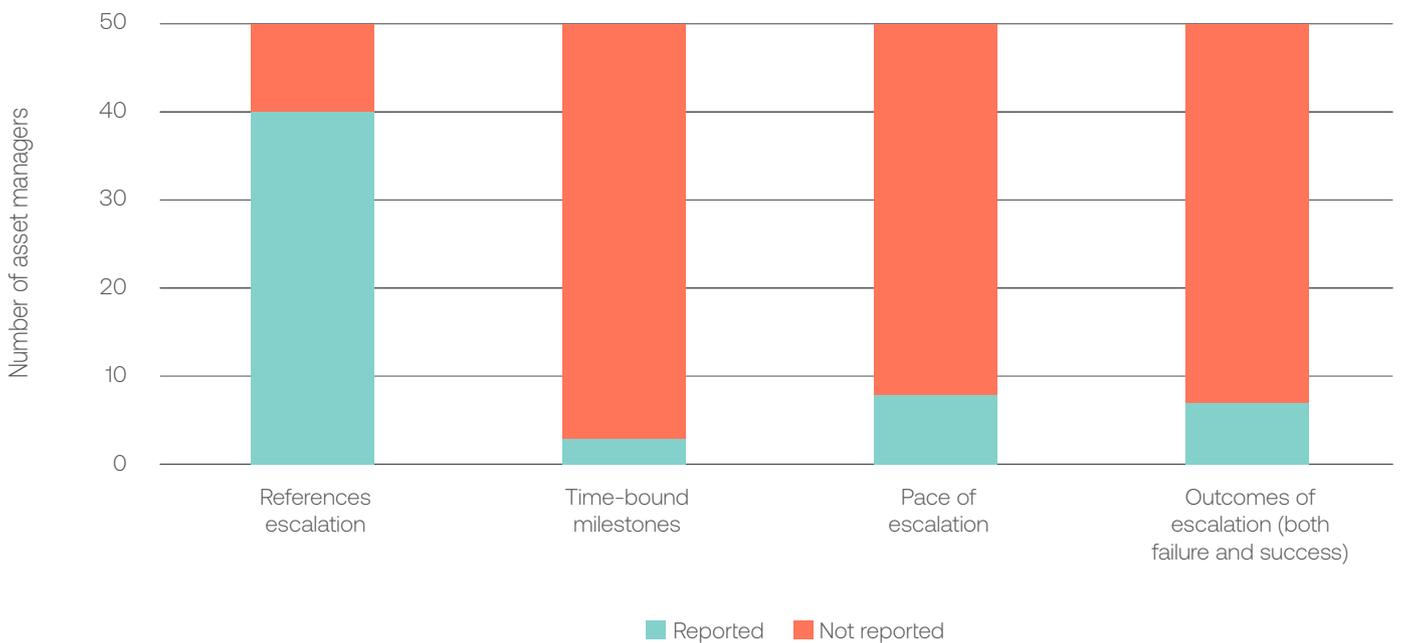
Escalation (and the reporting of outcomes) is an expectation of good stewardship, as recognised by the UK Stewardship Code,<sup>8</sup> which states as Principle 11: “Signatories, where necessary, escalate stewardship activities to influence issuers.” It is also part of the EU Sustainable Finance Disclosure Regulation,<sup>9</sup> and cited as an expectation by the Net Zero Asset Managers<sup>10</sup> initiative and Climate Action 100+.<sup>11</sup> The Institutional Investors Group on Climate Change (IIGCC) has also acknowledged the importance of systematic engagement – including time-bound objective setting and escalation – in raising the bar on climate stewardship.<sup>12</sup>

There are a number of challenges associated with engagement and escalation. Asset managers often cite preservation of their relationship with a portfolio company as a justification for not escalating, or concern about media coverage as a reason not to make a particular escalation public. However, escalation, including public action, can usually be accommodated within a constructive relationship. Indeed it may strengthen the relationship, by better aligning the asset manager and company while reinforcing the seriousness of the issue. An asset manager must aggregate all its clients’ (varied) interests and preferences into a single engagement voice. It is essential that asset managers fairly reflect the balance of all their clients’ interests and preferences into this aggregation and not default to the lowest common denominator.

## The current escalation landscape

ShareAction has reviewed the stewardship and sustainability reports of the 50 largest global asset managers, and finds that disclosure on escalation is limited and vague (Figure 1). Although the majority of asset managers reference escalation, on the whole they provide insufficient detail about the application and outcomes of escalation activities, including the pace of escalation. Further information on this research can be found on page 8 of the technical paper.

Figure 1: Asset managers' disclosure on escalation



## Summary of expectations

### » Expectation #1

Publish a policy that contains an escalation toolkit which progresses in strength, applies to corporate debt and listed equity holdings, and details how companies are selected for escalation

### » Expectation #2

Publish sectoral expectations on core environmental and social factors, with time-bound milestones

### » Expectation #3

Establish the anticipated pace at which asset managers will apply escalation if investee companies miss milestones — and then implement this..

### » Expectation #4

Measure and report comprehensively on the use of the escalation framework

### » Expectation #5

Ensure teams with escalation responsibilities are resourced appropriately and the framework is fully integrated into the investment and monitoring process

# The escalation framework



## The escalation framework

Figure 2: The escalation toolkit - for corporate debt and listed equity

	Listed equity	Corporate debt		
Business as usual dialogue and monitoring	Regular calls and meetings with the company Set clear and time-bound expectations on material responsible investment issues			
		Reiterate environmental and social expectations during bond syndication Request contractual protections of environmental and social factors in documentation		
	<b>Underpinned by broader systems engagement</b> (policy advocacy, sponsor academic research, contribute to investor forums, publish thought pieces etc)			
Private persuasion (STEP ONE)	Unilateral private calls/meetings with the company (non-routine, more frequent, with board members) Unilateral letter(s) to senior management and/or the board			
Broader challenge (STEP TWO)	Collaborative calls/meetings with the senior management and/or the board Collaborative private letters to senior management and/or the board Challenge management on earnings calls, corporate events or roadshows Unilateral public statements/letters to senior management and/or the board Collaborative public statements/letters to senior management and/or the board Be cited in the media challenging a company's position			
From talk to action (STEP THREE) Voting: 3.1	Vote against standing items incl. director (re)election, audited accounts, management compensation Vote for shareholder resolutions on ESG topics, against management recommendation Ask questions or making statements of intent at annual general meetings		STRENGTH	
Intensified actions: 3.2	Pre-disclose voting intention (private/public) (Co)Filing shareholder resolutions	Reject documentation amendment request Convene bondholder meeting (subject to holding threshold) and represent to company		
Exceptional measures: 3.3	Seek board seats Call an extraordinary general meeting			
	Legal processes			
Capital allocation decisions (STEP FOUR)	Divest/exclude from labelled funds* Reduce exposure/underweight in all funds* Engage index provider to exclude company at next rebalancing			
		Do not participate in primary issuance (new debt/refinancings) for labelled funds* Do not participate in primary issuance (new debt/refinancings) for all funds*		
Levers of last resort (STEP FIVE)	Divest and exclude (communicated privately to company)* Divest and exclude (communicated publicly)*			↓

\*While the capital allocation levers are less dynamic for passive funds, levers still exist in the form of engaging with index providers, and providing clean/aligned products for clients and encouraging them to transfer to these.

### Step 1: Private persuasion

This is a “step up” in private dialogue with the company, through: a) being held outside of the normal schedule; b) more clearly stating disapproval; and/or c) being held with more senior representatives. This stage does not include regular, routine meetings and/or calls with the company focused on information and updates to strategy. This step up signals to the company that a process of escalation has begun.

### Step 2: Broader challenge

The next step is more public, through sharing concerns with other investors or stakeholders. This sends a clear message about the importance of the issue and brings the debate into a public forum, encouraging other aligned investors to act. Some of the actions in Step 2 will be more effective if taken through collaborative initiatives; however, collaboration between asset managers does not in itself always constitute escalation, particularly where there is no intention to take stronger action if the collaborative engagement is unsuccessful.

### Step 3: From talk to action

The next step in escalation sees asset managers using their shareholder rights. Asset managers can indicate displeasure with a company through a variety of voting strategies. Voting for shareholder resolutions or against standing items, in opposition to management direction, signals dissatisfaction. This is also the case for voting against directors, a tactic that corporate accountability organisation Majority Action has found to be underutilised on climate issues.<sup>13</sup> This is emerging as an effective way of increasing accountability.<sup>14</sup>

It is important to note that asset managers can continue to use stronger tools in the toolkit without applying the earlier steps. Voting and pre-declaring support for shareholder resolutions on appropriate environmental and social issues is part of basic stewardship hygiene. Supporting the escalatory actions of other investors (such as co-signing letters) at companies that are not being engaged with directly is important to building legitimacy on reasonable asks and expectations. Other more severe actions in this step include pre-declaring voting intentions (which gives further momentum to shareholder resolutions) and filing or co-filing shareholder resolutions<sup>15</sup> (which are binding in some jurisdictions, including the UK, and can drive change even if not passed, as the action still sends a strong signal to management).<sup>16</sup> Both tactics are underutilised by large asset managers.<sup>17</sup>

Although far less common, this step can also include bondholders not consenting to a company request to amend bond documentation, or convening a bondholder meeting (subject to minimum holding thresholds), which can put the company on notice of the scale of bondholder concerns.

Additionally, tools such as calling an extraordinary general meeting, seeking board seats or legal processes (such as sending a legal letter or joining litigation) are included in this step. Legal strategies which address environmental and social concerns<sup>18</sup> may be brought for a range of reasons.<sup>19</sup> Legal strategies can result in companies having to absorb (or ‘internalise’)

some or all of the cost of their environmental or social impacts that is otherwise borne by (or ‘externalised’) society, through the potential for damages to be awarded. Further detail on the use of litigation, including potential barriers (such as cost and complexity) and actions that can be taken in response to these, can be found on page 23 of the technical paper.

These ‘exceptional measures’ are relatively resource-intensive, but are effective actions short of capital allocation that asset managers may wish to consider. Alternatively, given individual constraints or circumstances, moving straight to capital allocation decisions may be more appropriate.

Please see page 16 of the technical paper for examples in practice.

#### Step 4: Capital allocation decisions

The next step is the use of capital allocation, in the form of exclusion from ESG-labelled funds, underweighting in regular funds or non-participation in new equity or debt offerings. While capital allocation is traditionally thought of as distinct from stewardship levers, we view it as part of the escalation toolkit. The most effective way for asset managers to influence companies is through the combined use of capital allocation and stewardship levers. Making those actions public can further strengthen that influence.

Please see page 17 of the technical paper for examples in practice.

#### Step 5: Levers of last resort

These steps are used when prior steps fail to result in a positive outcome. Asset managers often express reluctance to divest on the grounds that this ends their opportunity to influence the company. However, unresponsive companies must face consequences for their inaction if escalation is to be effective, and divestment itself (or the credible threat of it) is an act of influence. And just as asset managers accept their lack of influence over companies they avoid investing in, so should they accept the loss of ineffective influence on companies they divest from. Furthermore, divestment is not always final – asset managers can make clear the conditions for reinvestment should companies begin to meet asset manager expectations.

Please see page 13 of the technical paper for examples in practice.

When an asset manager uses any tool in the escalation toolkit, they should clearly disclose the reasons for this to the company. This is particularly important for actions like voting against directors or divestment, where the company may be unaware and unable to consider responding unless the reason is explicitly communicated.

Asset managers can reinforce escalation actions by continuing to apply less severe tools alongside the more severe one. For example, an asset manager could reinforce the impact of voting for a shareholder resolution by continuing to make collaborative public statements.

## Prioritisation

Asset managers should ensure that their teams are resourced appropriately to steward their clients' assets. Investors should clearly state their process for prioritising companies for in-depth engagement and, if conditions are not met, subsequent escalation. This can include factors such as:

- Size of holding;
- Misalignment with any environmental or social criteria;
- Materiality of the environmental or social risk;
- Domicile of the company and/or the asset manager;
- Client and/or beneficiary preferences.

The process of prioritisation should be disclosed.

## The escalation pathway

The escalation pathway sets out how the asset manager will apply and move through the escalation toolkit. It begins with the asset manager publicly stating its core expectations on material environmental and social issues in key sectors. These expectations are underpinned by time-bound milestones. The asset manager also specifies the pace at which it will progressively apply escalation tools of increasing strength when a milestone is not met.

We recognise that every engagement has aspects that are particular to the circumstances of the company (its business model, domicile and financial profile) and the perspectives of the asset manager. However, engagements also have significant commonality. The environmental and social challenges can manifest across the economies that portfolio companies inhabit. The frameworks and research developed to address these challenges have broad application within, and often across, sectors. And the investor rights and levers of influence over companies are generally similar.

The proposed escalation toolkit and pathway accommodate the need for flexibility of application to each individual engagement while supporting an escalation process that is robust, comparable, transparent, well managed and oriented towards real-world change. The framework sets out a core architecture upon which individual escalations can be built and benchmarked.

# Considerations in implementation



# Considerations in implementation



## Collaborative engagement

**Collaborative actions can be a very powerful escalation tool and may take many forms, including self-organising investor-led collaborations, formal investor coalitions and/or collaborations between investors and NGOs.**

Collaboration amplifies key messages, gives more weight to individual asks and increases the incentive for the company to take action. It also reduces duplication and builds shared capacity between asset managers, as well as consolidating asks for companies. There are several studies showing the benefits of collaboration in engagement (for further details, please see page 11 of the technical paper).<sup>20</sup>

Competition or antitrust laws may be cited as a barrier to collaborative engagement on ESG issues. This is particularly the case in the US following the recent “ESG backlash”. While we recognise the complexities of collaborative engagement in different legislative environments, using these concerns as a reason not to collaborate may also reflect excessive caution, a misperception of regulators’ intent or simply an excuse for inaction. Regulators in several jurisdictions have made clear their commitment to sustainability and have communicated a desire to help remove blockages to collaboration on sustainability.

In the UK, the Competition and Markets Authority (CMA) has recently published guidance on environmental sustainability agreements, the Green Agreements Guidance.<sup>21</sup> This includes the section: “Agreements between shareholders to vote for promoting corporate policies that pursue environmental sustainability”, indicating that such activity is unlikely to infringe competition law and is therefore permissible. The UK’s Financial Conduct Authority (FCA) has committed to helping asset managers put ESG matters at the heart of their investment decisions and has called for UK investors to outline where they believe competition law has constrained their ability to collaborate.<sup>22</sup> The European Commission has recently included a new chapter in its Horizontal Guidelines to clarify that the antitrust rules do not stand in the way of agreements between competitors that pursue a sustainability objective.<sup>23</sup>

**ShareAction recommends that where competition law is seen to be a potential barrier to collaboration on ESG issues, asset managers should seek to address this with regulators (for example through the CMA’s open-door policy, whereby businesses can approach the CMA for informal guidance).**

There is also developing research around the idea of investors collaborating to set standards across whole sectors, as it is “more likely to level the playing field and create the conditions for supportive legislation across jurisdictions”.<sup>24</sup> This idea is built upon in the “guardrails” approach

suggested by the Shareholder Commons, where collectively agreed minimum standards between investors allow competition within sustainable boundaries.<sup>25</sup> The initial mechanism for implementing guardrails would be a collective request from investors to a select group of companies to commit to one or more specific guardrails, along with a statement of intent to vote against directors if the guardrail is not adopted.



## Regional variations

Variations in local norms and regulation may mean that not all the tools in the toolkit are applicable in each case. Asset managers can adapt this toolkit to the region in which they are based and the location of the company. Resources such as ClientEarth's Know Your Rights<sup>26</sup> are valuable guides to the varying legislative contexts facing asset managers.

However, even where one tool may be unavailable or inappropriate, there will still usually be other tools in that escalation category that can be used; therefore it should still be possible to move through each step in the escalation toolkit, or to skip to the following step where appropriate. Notwithstanding regional variations, the escalation toolkit and pathway are broadly applicable.



## Fixed income

Bondholders can and should be impactful stewards. Investors should give proportionate emphasis to their fixed income and equity holdings, utilising different tools where appropriate to engage. Integrating bondholder interests and voice into stewardship efforts can result in strengthened engagement. Asset managers should also ensure that any decisions to participate in new financings are consistent with the company's progress on meeting expectations. Not participating in a financing can be an effective escalation tool.

The maximum point of influence for a bondholder is primary issuance, whereby participation in financing is conditional on expectations being met. However, the window to influence in primary syndication can vary quite significantly, from a "drive-by" (i.e same day) issuance by well-known investment-grade borrowers, to a full roadshow (over a number of days) for high-yield bonds or private placements. The groundwork for influencing most investment-grade borrowers therefore needs to be laid well before the financing window, through regular ongoing engagement.

Bondholders also have opportunities to engage and influence those private companies who access debt markets, including sovereign-owned entities and private equity portfolio companies. These companies can be material contributors to environmental and social risks and impacts, but are outside the scope of listed equity focused stewardship. By engaging with these companies, bondholders can therefore materially expand the effectiveness of overall stewarding of environmental and social factors.

Investors sometimes pursue a partial divestment or non-participation approach, in which they do not finance longer-dated bonds. The rationale is that these bonds have greater exposure to systemic risks such as climate change. However, the effective risk horizon of a bond to systemic factors extends well beyond the maturity date of the bond. This is because the ability to refinance that bond at maturity will likely be influenced by the risk profile of the borrower over the subsequent bond tenor. A six-year bond is therefore sensitive to risks that manifest in year seven and beyond. As such, bond investors should consider all tenors as potentially exposed to and influencers of relevant environmental and social factors.



### Passive asset managers

Passive funds are responsible for significant investment across the financial system. Because the capital allocation lever is less dynamic than for active funds, the onus for active engagement and use of escalation – for example, by using voting rights – with portfolio companies is even stronger. Further, passive asset managers still process some capital allocation levers, as they can offer clients “clean” products or indices from which unaligned exposure has been removed. Passive asset managers can then inform clients of the benefits of moving the capital into these “clean” funds, and seek to remove or abate barriers (such as higher fees or weaker liquidity terms). Passive funds can also engage directly with index providers to remove unaligned companies.



### Existing engagements, policies and guardrails

This framework is designed to bring coherence to escalation and encourage effective engagement as a minimum standard. Overlaid on this minimum standard should be the existing policies, including any sector “guardrails” at the asset manager that supersede the framework in ambition. Current escalations should be integrated into the framework at their existing level of strength.

Asset managers should also consider skipping steps due to: a) the urgency of the issue (for example climate change or nature loss); b) the existence of established voting policies or guardrails; c) collaborative engagement actions that they wish to participate in; or d) evidence that the company has been unresponsive to other asset managers at lower levels of escalation. Additionally, a major incident that does not fall within the asset manager’s existing sectoral expectations may prompt acceleration, including skipping steps where appropriate.



## Breadth vs depth

Credible and impactful engagement requires effort and expertise. Asset managers should ensure that they have sufficiently invested in the resources to be able to conduct this type of deep engagement across companies and sectors. However, there will be a limit on capacity in relation to how many companies an asset manager can conduct deep engagement with at any one time. At the same time, broad support is also an important criteria for effective engagement. This need for depth and breadth can be in tension. Asset managers should resolve this by leading direct engagement with prioritised companies while also considering supporting escalation by other investors where the asset manager is not directly engaging with the company. This can be:

- Where the asset manager has observed engagement undertaken by other stakeholders on an issue covered in the asset manager's own sectoral expectations without an adequate response from the company;
- Where the asset manager has not had capacity to engage directly but the engagement asks are clearly aligned with the asset manager's sectoral expectations and the company is lagging on the sectoral milestones.



# Expectations in detail



## **Expectation #1: Publish a policy that contains an escalation toolkit which progresses in strength, applies to corporate debt and listed equity holdings, and details how companies are selected for escalation**

### **Problem**

Although escalation is often referenced in asset managers' sustainability and stewardship reports, details on that escalation and how asset managers intend to use each tool is vague and inconsistent. How different escalation tools are selected and coordinated to effectively add impetus to the engagement is often unclear.

### **Solution**

The asset manager should publish a policy that articulates its definition of "escalation" and an escalation toolkit, as detailed above. This should commit to structured and sequenced use of escalation tools, shaped by prioritisation. Academic research shows that engagement that is public<sup>27</sup> or includes the possibility of exclusion<sup>28</sup> can be effective in driving changes in company behaviour such that it aligns with clients' long-term interests and mitigates negative impacts. Other studies have shown that a combination of engagement tactics is more impactful than the use of any one individual tactic alone.<sup>29</sup> ShareAction's escalation toolkit therefore includes multiple tactics, including those related to exclusion and public actions (for further details, please see page 7 of the technical paper).

## **Expectation #2: Publish sectoral expectations on core environmental and social factors, with time-bound milestones**

### **Problem**

Current disclosure includes little detail on the substantive and tangible core sectoral expectations on which asset managers place their individual company engagements, or the time-bound milestones on the path to meeting those expectations. This results in a lack of clarity for stakeholders, including clients, civil society organisations and investee companies themselves.

### **Solution**

Asset managers should publicly disclose their foundational expectations of each sector (or subsector) with material environmental or social exposures, together with time-bound intermediate milestones set to meet those expectations. This will give stakeholders transparency on the goals of engagements and the pace at which companies are expected to meet expectations and milestones. It will prepare companies for investor asks and help asset managers to identify common ground as they seek to address collective, systemic threats. These sectoral expectations should be the foundation of engagement with companies and the trigger for subsequent escalation if the expectations are unmet. The expectations should

be the focal point of engagement, enhanced and adapted as appropriate to the specific circumstances of the company. It is also vital that expectations include those that are action-oriented, as well as those that are focused on better disclosure or governance. Governance and disclosure can be very important enablers of change, and escalating to change management or board members can be a powerful lever for achieving desired environmental or social outcomes. However, these levers are not change itself.

Expectations should be:

- In line with existing, credible, consensus-based frameworks (for example the Paris Agreement, the Global Biodiversity Framework, the UN Global Compact principles, the SDGs, the Science Based Targets initiative, the International Energy Agency);<sup>30</sup>
- Sector expectations should be publicly communicated and updated as needed, and company-specific expectations communicated to the company at the start of engagement;
- Centrally coordinated across all corporate equity and debt.

Time-bound milestones should:

- Clearly reference a specific point in the future, either relative or absolute, by which each milestone should be met;
- Credibly plot a path to deliver the expectation, with reasonable contingency headroom;
- Contain initial milestones for the short term (one to two years) to discourage companies from dragging their heels on material issues requiring immediate progress (such as climate change).

Asset managers may choose to align their expectations to those suggested by engagement initiatives, such as Climate Action 100+, and should highlight that alignment when disclosing their expectations, identifying any areas of divergence (expectations that are omitted, added or amended).

The technical paper provides illustrative examples of milestones (from page 26).

### **Expectation #3: Establish the anticipated pace at which asset managers will apply escalation if investee companies miss milestones, and then implement this**

#### **Problem**

Information is limited on how asset managers are coordinating and sequencing the application of escalation tools to predictably increase pressure on companies who are not responding sufficiently to engagement. This opens the door to continued inaction by companies without consequence.

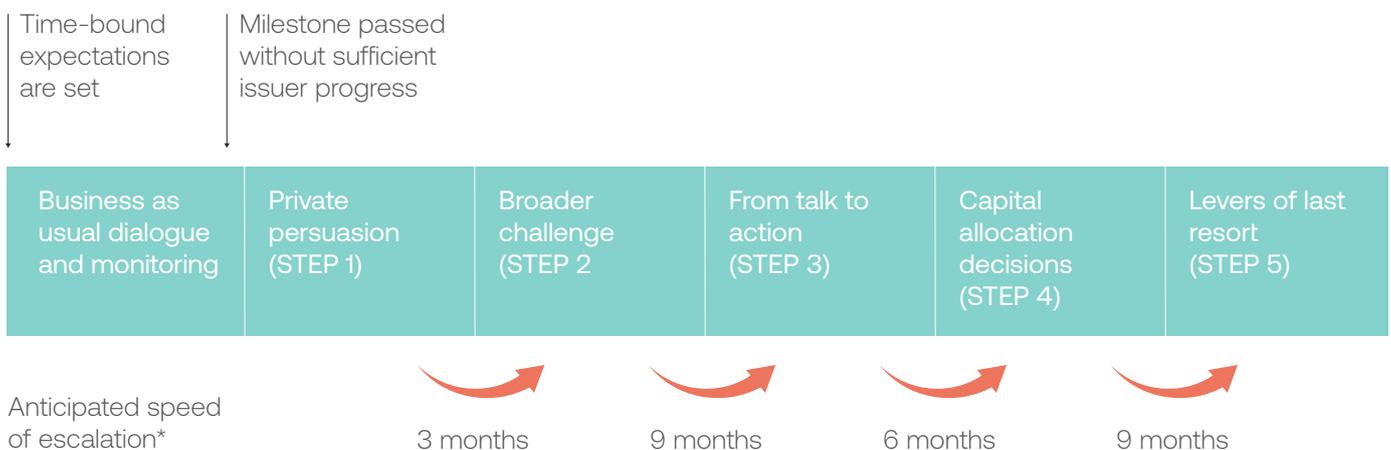
## Solution

Asset managers should pre-set and publicly disclose the expected pace at which they will progress through escalation for companies who miss milestones. This should be on a sector-by-sector basis, and should consider:

- Urgency.** For example, with the global carbon budget to stay within 1.5°C estimated to be consumed in six years,<sup>31</sup> asset managers should ensure that any escalation on decarbonisation strategies is correspondingly urgent.
- Timing.** Due to the timing of events like annual general meetings or a debt refinancing, asset managers may want to accelerate or push back the use of particular escalation tools (such as filing shareholder resolutions or indicating that they will not participate in the bond refinancing of an unresponsive company).

A model of anticipated escalation pace is shown below (Figure 3) – for more specific illustrations of how escalation pace can be applied, please see page 29 of the technical paper. We note that the pace of anticipated and actual escalation may differ due to individual company circumstances. Where the pace is slower than indicated in the sector pathway, the asset manager should disclose this fact and the reasons for it.

Figure 3: Pace of escalation



\*Illustrative – asset manager has discretion to determine appropriate pacing for each sectoral expectation, which they will then disclose.

## **Expectation #4: Measure and report comprehensively on the use of the escalation framework**

### **Problem**

As shown by ShareAction's research,<sup>32</sup> the form and use of escalation by asset managers is largely opaque to stakeholders, including their clients. Without this information, it is difficult to compare how effectively asset managers are using their influence to drive change at companies to represent their clients' interest.

### **Solution**

"Asset managers should report on their use of the escalation framework. Categorising escalation tools according to their strength facilitates a more streamlined reporting approach, where asset managers can group tools of similar strength rather than reporting on the use of each tool. This will allow stakeholders to assess asset managers' escalation activities and outcomes effectively. Reporting should set out expectations and time-bound milestones by sector, escalation pace by sector, the number of escalations under each step in the reporting period and the outcome of escalations. Effective and organised escalation depends on the support of underpinning systems, and asset managers should ensure that they use data management tools to track, coordinate and measure escalation where suitable. Reporting should ideally be: a) as consistent as possible year on year, to allow for comparison; and b) in a machine-readable format to assist with data gathering. For more details, refer to page 31 of the technical paper (see Figure 4 below).

Figure 4: Sample reporting expectations

Theme	Details	Additional details
Definition of escalation and its purpose		
Expectations and related milestones by sector	Including details of more specific expectations for named companies, if appropriate	
Escalation pace by sector	Including details on # of instances the implemented pace was slower than indicated, with the reasons why	
Use of escalation in the reported period	Number of companies at each escalation step	By sector/region/theme
	Average time spent at each escalation step	
	Number of times each escalation tool was used	By sector/region/theme/ collaborative or non- collaborative
Outcomes	Number of companies taken off the escalation toolkit due to success	By sector/region/theme
	Number of companies that reached the final step of the escalation toolkit	By sector/region/theme if possible, named
	Number of companies that moved up one step or more in the escalation toolkit	By sector/region
Case studies	Clear articulation of the specific role the asset manager played in influencing the company	
	Detail on the changes made by the company	
	Examples of both failure as success	
Resourcing	Examples across different geographies and asset classes	
	Reporting on the # of individuals (on a full-time equivalent basis) in activities related to engagement (depending on model)	

## Expectation #5: Ensure teams with escalation responsibilities are resourced appropriately and the framework is fully integrated into the investment and monitoring process

### Problem

Clients entrust capital to asset managers to invest and steward thoughtfully, in their best interests. If an asset manager has insufficient resources dedicated to stewarding capital relative to the resources dedicated to investing capital, these interests may be underserved. Lack of appropriate resourcing therefore undermines the potential for effective engagement.

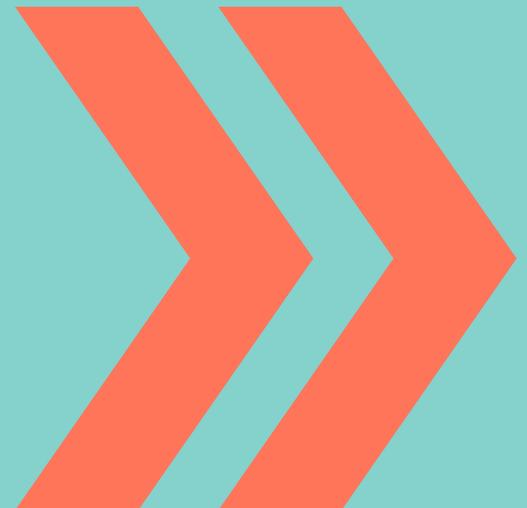
### Solution

The credibility and expertise represented in engagement are vital criteria for generating effective outcomes. Asset managers should consider the following when resourcing teams involved in escalation:

- **Expertise.** Teams responsible for escalation should have knowledge across environmental and social risks and impacts, combined with negotiating skills and understanding of the escalation tools available. They should also ensure that internal expertise is informed by credible external sources.
- **Capacity.** Asset managers must ensure that stewardship capacity is resourced appropriately.<sup>33</sup>
- **Responsibility.** Responsibility for development and oversight of the escalation framework should sit at a senior level, ensuring top-down leadership and commitment. This oversight function should have adequate expertise on environmental and social issues to appropriately inform the engagement and escalation approach.
- **Integration with investment teams.** Investment teams should closely interact with the stewardship function, so that both teams understand the potential financial materiality of environmental and social issues, and that investment decisions are aligned with and informed by engagement goals and outcomes.
- **Reporting.** Asset managers should report on the level of resource, indicating how it has been calibrated to steward clients' capital appropriately.



# Conclusion



# Conclusion

Escalation is a powerful tool in influencing change at companies that are having damaging impacts on, and are exposed to risks from, environmental and social factors. Due to the current lack of standardised reporting on escalation, as well as on engagement more widely, it is currently not possible to assess how and under what conditions escalation tools are being used. For clients, this means they cannot effectively gauge their asset managers' engagement activities. For other stakeholders, including civil society organisations, regulators and peers, it slows the shared learning about which escalation tools are most effective in driving real-world outcomes.

This standardised escalation framework will enable consistent reporting, so that the use of escalation tools can be measured and compared between asset managers. The escalation framework introduces a coherent, overarching structure, while allowing for bespoke application to individual company circumstances. It can also encourage more consistency between asset managers, and greater ambition and purpose in their engagements. The urgency of the environmental and social crises cannot be ignored, and asset managers should ensure that their escalation reflects this.

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ShareAction is an NGO working globally to define the highest standards for responsible investment and drive change until these standards are adopted worldwide. We mobilise investors to take action to improve labour standards, tackle climate change and address pressing global health issues. Over 16 years, ShareAction has used its powerful toolkit of research, corporate campaigns, policy advocacy and public mobilisation to drive responsibility into the heart of mainstream investment. Our vision is a world where the financial system serves our planet and its people.

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## Authors

Niall Considine, Susanna Hudson,  
Danielle Vrublevskis

# ShareAction»

[shareaction.org](https://shareaction.org)  
[info@shareaction.org](mailto:info@shareaction.org)  
+44 (0)20 7403 7800

Runway East,  
2 Whitechapel Road,  
London, E1 1EW, UK

Registered Charity  
Number: 1117244

EU Transparency  
Register number:  
75791956264-20