1 EXECUTIVE SUMMARY

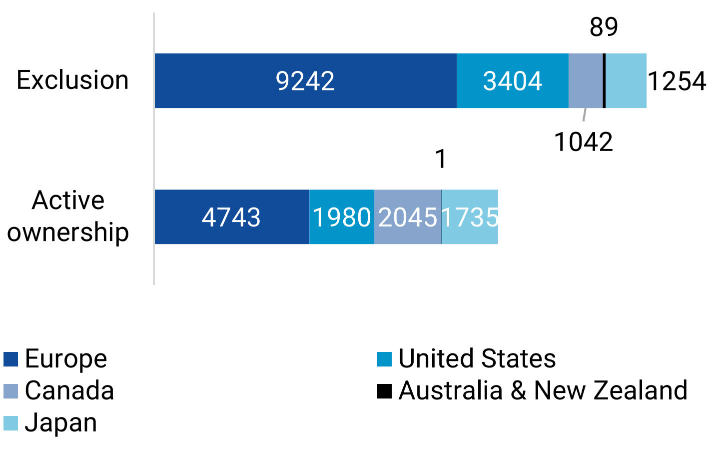
Exit vs. voice – this is the general choice that responsible shareholders face when invested in a company that behaves in a way that does not align with their values. The first option is to dissociate themselves and divest. The second is to engage in dialogue to initiate positive change. The latter strategy refers to active ownership and is the focus of this analysis.

But what is active ownership and how is it applied in practice? What is its impact on the target company and the investor engaging? What are the factors that make it successful? These key questions will be addressed throughout an E4S series. The first study of this series focuses on answering the former of these questions.

Active ownership generally applies to publicly traded shares and is based on two main components: voting and engagement. Both are extremely interrelated, complement each other and can be triggered by one another. Shareholders wishing to express their opinion more than with their voting rights will engage in a direct dialogue with the company and can choose from a variety of tools to develop their strategy. Engagement can be private or public, individual or collaborative, or a combination depending on the responsiveness of the target company. If the dialogue with the company does not bear fruit after a certain period of time, investors will be more public with their engagement and, if it is not already the case, will try to convince other shareholders to join the cause in order to increase the pressure exerted.

The themes and players are diverse, and the regulations and culture around active ownership vary by region. Shareholders engage on four main themes: environmental and social issues, board management, shareholder rights and compensation structure. The active shareholder ecosystem consists of many players including

Sustainable investment per region in 2020 (left) and evolution of sustainable investment in USD billion (right)



Note: Active ownership is here defined as "employing shareholder power to influence corporate behaviour, including through direct corporate engagement, filing or co-filing shareholder proposals, and proxy voting" on ESG issues. Exclusion is here defined as "exclusion from a fund or portfolio of certain sectors, companies, countries or other issuers based on activities considered not investable". Source : Global Sustainable Investment Alliance (2021) institutional and retail investors, whistle-blowers such as NGOs, employees, or civil society, data providers such as rating and proxy voting agencies, as well as governments and regulators. In both Europe and Switzerland, the culture of consensus and stricter regulations favor collective and co-operative approaches, in contrast to the American modus operandi.

Engagement is increasingly extending to other asset classes such as corporate and sovereign bonds, as well as private equity. Creditors can engage both before and after securities are issued but may face limitations in their initiatives, such as the presence of diverse preferences within the creditor group and a perception of interference with the public policy of an issuing government. In the private markets, general partners, driven by demand, are increasingly engaging on ESG issues and can leverage the private equity model, which is particularly favorable to engagement, to achieve their goals.

KEY TAKEAWAYS

1. Active ownership, through engagement and voting, is growing in popularity among responsible investors and is spreading to more and more asset classes, such as corporate and sovereign bonds, as well as private equity.
2. This popularity has been amplified by the increased attention paid to environmental, social and governance issues by stakeholders and has intensified the importance of these same issues at the boardroom table.
3. Some practices, such as the lack of voting rights for exchange-traded fund shareholders or the increase in multi-class share issuance, may be a barrier to this trend.
4. But the development of investor groups and digitalization tend to favour new approaches to active ownership.

E4S SERIES ON ACTIVE OWNERSHIP

This analysis dives into the practices of active ownership. But what about its impact? In December 2021, E4S studied **the impact of divestment** as a responsible strategy. The second analysis in the E4S series on active ownership, **Active ownership: for what impact?** applies the same approach, balancing the benefits and costs for the investor who engages and discussing the reactions and behavioural changes of the target company. To be successful in their engagements, however, investors will need to consider several factors. **Active ownership: the keys to success** develops how the profile of the target company and of the investor, as well as the characteristics of the engagement, can influence the outcome of a shareholder initiative.

Active ownership: by whom and how?

E4S White Paper

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