Löning | Human Rights & Responsible Business

Engagement: a tool for fostering change in respecting human rights

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Research context

To create effective stewardship, ASN Bank wants to analyse how engagement with investee companies can be used as a meaningful tool for promoting and, ideally, ensuring respect for human rights by investee companies. This research intends to answer the following questions:

Can engagement be used as a tool for fostering change in the investee companies' human rights impact management?

Which elements can contribute to making engagement meaningful?

The research was commissioned by ASN Bank and developed by Löning – Human Rights & Responsible Business.

Introduction

The financial services sector plays a special role in driving sustainable change due to the leverage financing companies have as lenders of business activities. This unique leverage carries with it heightened stakeholder expectations towards the financial sector's responsibility to respect human rights.

Despite the predominant focus on the "E" in ESG (environmental, social, governance factors) in corporate sustainability practices, institutional investors are increasingly integrating the "S" in ESG in their decision-making processes, a trend that was accelerated due to the COVID-19 pandemic.[01] Respecting human rights is an integral part of the "S" and imperative to responsible and sustainable business conduct.

Indeed, clients are increasingly asking institutional investors how their investment and lending choices affect human rights.[02] Civil society is closely monitoring institutional investors' role in the human rights impacts of investee companies.[03] Meanwhile, lawmakers are setting the ground for sustainable business practices of the financial sector. Additionally, it is the fiduciary duty of institutional investors to consider long-term investment value drivers, which may include human rights (which also cover labour rights) issues within the ESG sphere.[04]

Box 1: A selection of regulatory developments

The **Sustainable Finance Disclosure Regulation** (SFDR), which has been in force since March 2021, requires financial market participants and financial advisors to publicly disclose information about principal adverse impacts of their investment decisions on, amongst others, human rights. This disclosure entails a summary of company engagement policies.

A sustainable finance package was adopted on 21 April 2021 which incorporated several legislative amendments: The proposal for a **Corporate Sustainability Reporting Directive** (CSRD) amends the existing reporting requirements of the Non-financial Reporting Directive (NFRD). It introduces the concept of double-materiality, i.e. sustainability risks affecting the company (outside-in) and companies' impacts on society and environment (inside-out) while also requiring disclosure on intangibles such as social or human rights issues and mandatory audits. The **amendments in relation to sustainability preferences, fiduciary duties and product governance** are expected to come into force in 2022. These amendments require sustainability topics (including human rights) to be addressed in fund management and advice.

The **EU sustainable corporate governance initiative** is currently being drafted. A proposal on human rights and environmental due diligence rules is expected to be launched in 2021.

The upcoming EU Taxonomy defines criteria for when an economic activity can be called "environmentally sustainable", and it includes minimum safeguards that need to be fulfilled. In the **EU Renewed Sustainable Finance Strategy,** the EU Commission is considering extending the EU Taxonomy Regulation to include a **social taxonomy,** which, according to a draft report, would be based on the UNGPs.

The United Nations Guiding Principles on Business and Human Rights (UNGPs)[05] and the OECD Guidelines for Multinational Enterprises[06] are the authoritative frameworks for businesses on the respect of human rights and provide businesses with guidelines on how to do develop a human rights policy, conduct effective human rights due diligence, and provide access to remedy to impacted stakeholders.

Human rights due diligence entails the adoption of measures to prevent and mitigate potential adverse impacts on human rights and to create a positive impact. In the investment universe, this relates to meaningful stewardship, which requires meaningful engagement with investees. It encompasses understanding the company culture and context, setting up milestones together, and measuring and monitoring performance closely.

This short study will take a closer look at the role of engagement practices and how engagement can be conducted meaningfully.

01 A report by DWS shows for instance the rise of the "S" in ESG in pension portfolios. A survey by Berenberg WAM finds that the importance of the social aspects for investors has increased due to the pandemic. 02 A study by Finance & Human Rights and the Geneva Center for Business & Human Rights, commissioned by Luxembourg for Finance in 2020, shows that clients are among the key stakeholders driving the need to address human rights in financial institutions. 03 See for instance the BankTrack Human Rights Benchmark 2019 or ShareAction's rankings 04 PRI (2018): A practical guide to active ownership in listed equity 05 United Nations (2011): Guiding Principles on Business and Human Rights 06 OECD (2018): OECD Due Diligence Guidance for Responsible Business Conduct

What is engagement and its role in the context of human rights?

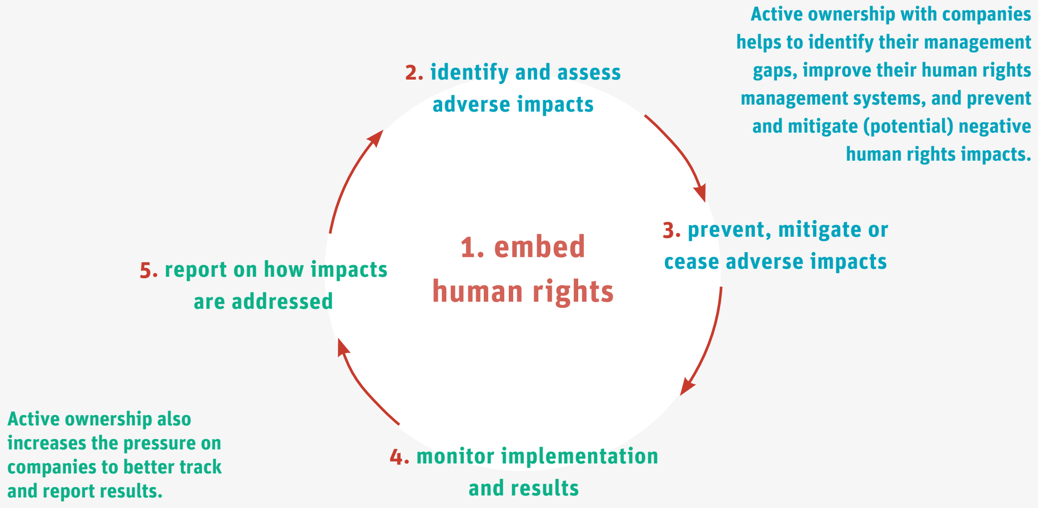
The UNGPs and the OECD Guidelines, the authoritative instruments relating human rights responsibilities to the corporate world, state that every business enterprise, including financial institutions, needs to implement due diligence, i.e.,

1. embed responsible business conduct in investor policies and management systems;
2. identify actual and potential adverse impacts on human rights;
3. seek to *prevent or mitigate adverse human rights impacts* and use or increase *leverage* (either alone or in cooperation with others) to influence the entity (in this case the [potential] investee company or the company receiving financing) to prevent or mitigate a negative impact;
4. track and communicate results; and
5. set up a remediation process.

Box 2: Principle 13 of the UNGPs

"The responsibility to respect human rights requires that business enterprises (a) avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur; [and] (b) seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts."

Human rights due diligence



Graphic 1 shows the ongoing and continuous process of effective human rights due diligence.

Active ownership is an important part of the human rights due diligence process for investors, as it helps detect gaps in companies' human rights management systems, prevent human rights violations and/or mitigate them if they have already occurred.[07] Thus, financial entities wanting to comply with the UNGPs need to be "active owners" and use or increase their powerful leverage and influence to engage with companies on human rights issues as a crucial part of their responsible investment strategy.

Active ownership (also known as stewardship), as defined by the United Nations Principles for Responsible Investment (PRI) in the context of listed equity, is the "use of the rights and position of ownership to influence the activities or behaviour of companies" and includes engagement and voting activities as key tools in the responsible investment strategy.[08]

Graphic inspired by OECD (2018): OECD Due Diligence Guidance for Responsible Business Conduct

07 OECD (2017): Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, p. 32
08 PRI (2018): A practical guide to active ownership in listed equity, p. 11

Active ownership

ENGAGEMENT

Engagement refers to all interactions on ESG issues between the financial institution and (potential) clients, with the ultimate goal to improve ESG practices and disclosure. It is based on a two-way dialogue and continuous monitoring.

VOTING

Voting refers to the financial institution's use of its voting rights to express its concerns and approval on different topics. Voting on management and/or coordinating or participating in shareholder resolutions are two ways of using the voting power. Voting can be conducted face-to-face, during an annual general meeting (AGM), or by delegating it (proxy).

"Voting and engagement practices are interrelated and feed into each other; one can be the initiator or the complementary tool of the other." [09]

Figure inspired on PRI (2018): A practical guide to active ownership in listed equity [09] PRI (2018): A practical guide to active ownership in listed equity, p. 11

There are different types and different levels of engagement. The approach towards engagement varies between the different investors. The PRI defines three levels of engagement, which are mirrored in the existing literature: direct engagement, collaborative engagement, and outsourced engagement.[10]

- *Direct engagement* is conducted in-house, which means that investors are responsible themselves for defining their engagement and voting program, developing their priorities, setting clear goals, and, as the final step, engaging and voting.

- In *collaborative engagement,* investors work together as a group to engage with a company or a range of companies. This can, but does not have to, be done within a formal investor network such as the PRI, the Investor Alliance for Human Rights (IAHR) or multi-stakeholder-initiatives, such as the Asia Sustainable Finance Initiative (ASFI).

- Engagement can also be *outsourced* to an external party such as an investment manager or a specialist service provider.

The different levels of engagement bring their specific benefits and disadvantages. Often, in-house and external practices are combined in order to leverage the advantages of the different engagement levels and achieve optimal results. Table 4 in Annex II provides an overview of the advantages and disadvantages of each level of engagement.[11]

Another element that can differentiate engagement practices is the element that triggers such action. Engagement can be conducted proactively to improve a company's human rights performance and/or be used as a reactive measure to eliminate or mitigate actual negative human rights impacts. When referring to these two engagement practices, we rely on the following definitions:[12]

- *Proactive engagement* is based on a company's preventive analysis of material human rights issues.
- *Reactive engagement* is related to a reaction to a controversy or scandal, often addressing primarily financial and reputational risks.

Box 3: Types of engagement at ASN Bank

ASN Bank makes a differentiation between light engagement, active engagement, and collective engagement.[13]

- *Controversy engagement* occurs when sustainability criteria in terms of policy are no longer met, but no misconduct has been identified. The company needs to improve within four years'.
- *Active engagement* is conducted if a serious misconduct is identified at a company or if a policy is lacking and the four-year period is deemed inappropriate. Active engagement takes a maximum of one year and the outcome of the engagement is described in the company profile. The Investment Committee then takes a final decision on the company.
- *Collective engagement* can take several years and is conducted either alone or collaboratively with other investors when similar misconduct is observed in several cases in a sector or specific area.

These different types of engagement are not mutually exclusive and can be combined.

Note: ASN Bank's engagement strategy is currently being revised.

10 PRI (2018): Assessing active ownership through engagement and voting 11 Main elements from interviews with experts, and PRI (2013): Getting started with collaborative engagement, PRI (2018): A practical guide to active ownership in listed equity, p.39-40 12 PRI (2018): A practical guide to active ownership in listed equity, p. 31 13 ASN Bank (2020): Guide – Sustainability Criteria

Can engagement be used as a tool for fostering change?

Engagement is an integral tool in conducting a human rights due diligence. To date, studies have provided evidence that engagement can bring significantly better financial returns, more integrated strategies, and reduced risks.[14] Recent academic studies show that shareholder proposals can increase the ESG ratings of investee companies and suggest that engagement can be used as a tool for positive investor impact.[15] They specifically show that successful engagement with companies with low ex-ante ESG performance leads to a higher ESG score by independent evaluation providers.[16]

Many financial institutions increasingly use engagement as a responsible investment strategy.[17] One of the six principles of the PRI is to be an active owner.[18] But does engagement actually drive change when it comes to respecting human rights? The PRI has looked at the benefits of ESG engagement for companies and financial institutions. The three key benefits are: improved learning dynamics, communication dynamics, and political dynamics. All three are further explained in Table 1.[19]

Table 1:
Benefits of engagement for financial institutions and clients

Benefit	Explanation
Learning dynamics	Engagement helps to create a learning value by enabling an increased ESG knowledge on both sides.
Communication dynamics	Engagement creates a communicative value by enhancing an improved exchange of information between both parties.
Political dynamics	Engagement creates a so-called political value by building stronger internal relationships, shifting more importance to internal stakeholders working on sustainability issues in companies, increasing their internal leverage, and enabling investors to build long-term relationships with companies. These advance collaboration and ESG integration.

Reflecting on these three benefits, we can assume that there is a potential for engagement to foster change in the corporate culture and capacity to manage human rights issues. Based on the PRI study,[20] it is understood that, via engagement actions, investors may, for instance:

- Spot gaps not previously identified by investee companies;
- Identify and diffuse best practices, improving the capacity of investee companies to access this knowledge;
- Impact internal political dynamics of investee companies, reinforcing the position and status of ESG experts within the organisations;
- Impact the likelihood of securing ESG resources within the organization;
- Push investee companies to improve reporting systems, by seeking for detailed and accurate information;
- Push investee companies to improve management systems, by setting and monitoring objectives and targets; and
- Set a higher level-playing field by expecting the same level of ESG performance from each company within a specific sector.

The extent of the impact generated solely by engagement actions is not precisely known. However, one can affirm that investors play a key role in encouraging investee companies to change behaviours, alongside other important groups of stakeholders such as governments, NGOs, consumers, and employees.

Table 2 shows a selection of case studies where engagement efforts showed clear positive results.

Box 4: ABN AMRO on the relationship between engagement and improved ESG management

"We strive to increase the likelihood that clients will address negative ESG impacts. But we can rarely be sure there is a causal relationship between engaging with our clients and the actions these clients subsequently take to improve their management of ESG issues. Often, ABN AMRO is one voice among a diverse group of consumers, NGOs, other banks and governments who pursue the same objective through different means."[21]

14 PRI (2018): A practical guide to active ownership in listed equity, p. 8. Dimson, Karakas and Li (2015), Junkin, CFA, CAIA (2015), and Becht, Franks, Mayer and Rossi (2010), as cited in PRI (2018): A practical guide to active ownership in listed equity, p. 15 15 Barko, Cremers and Renneboog (2021): Shareholder Engagement on Environmental, Social, and Governance Performance. European Corporate Governance Institute – Finance Working Paper No. 509/2021. Dyck, Lins, Roth, Wagner (2018): Do institutional investors drive corporate social responsibility? International evidence. Journal of Financial Economics, Volume 131, Issue 3, pages 693-714. 16 Barko, Cremers and Renneboog (2021): Shareholder Engagement on Environmental, Social, and Governance Performance. European Corporate Governance Institute – Finance Working Paper No. 509/2021. 17 The yearly market report by Forum Nachhaltige Geldanlagen finds an increase in the use of engagement in Germany in 2020. For instance, ESG integration is applied to 96 per cent of responsible investments, usually in combination with engagement and/or standards-based screening. 18 About the PRI 19 PRI (2018): How ESG engagement creates value for investors and companies 20 PRI (2018): How ESG engagement creates value for investors and companies 21 ABN AMRO (2020): Non-financial data & Engagement 2020

Table 2: Case studies

Financial institution/entity	Engagement	Results of engagement
Norges Bank *Source: Norges Bank Investment Management*	In April 2018, Norges Bank Investment Management was tasked by Norges Bank's Executive Board to engage with UPL Ltd on the risk of child labour at its subsidiary Advanta Seed Pty, a producer of seeds in India.	Advanta continued an information campaign for various stakeholders such as farmers, suppliers, and local authorities, and hired external experts to provide feedback and improve this work. Furthermore, Advanta joined a new sector initiative to fight child labour and ensure decent working conditions and commissioned a baseline study of the root causes for child labour in seed production. The company has also updated its standard agreements with farmers and, finally, strengthened its processes for monitoring its supply chain to identify risks of child labour.
Council on Ethics of the Swedish National Pension Funds *Source: Council on Ethics of the Swedish National Pension Funds*	Since 2016, the Council on Ethics has been part of an initiative together with other investors and the PRI that engages in dialogue with around 15 companies in the electronics and automotive industries, for instance Apple, Microsoft, Daimler, and Volkswagen, with the aim of promoting an improved, more responsible extraction of cobalt. The extraction of cobalt is often connected to severe human rights risks such poor working conditions and child labour.	The Council has observed positive results that vary between companies. In general, the companies' understanding of and transparency about their supply chains have improved. Apple has mapped its supply chain and introduced minimum requirements and audits. Daimler now only buys cobalt from certified mines.

APG

Source: APG

Following the military coup in Myanmar in February 2021, the human rights situation in the country worsened drastically. The position of APG, a Dutch pension investment company, is to not invest in government bonds of countries that are subject to a binding weapons embargo imposed by the European Union or the UN Security Council. Therefore, APG engaged, also on behalf of pension fund clients, with the South Korean steel producer Posco C&C to end its joint venture with Myanmar Economic Holdings Limited (MEHL), a company controlled by the Myanmar military.

Posco C&C announced in April 2021 that it will sever its ties with MEHL.

Global Investor Engagement on Meat Sourcing

Source: Fairr

In 2019, the collaboratively led Global Investor Engagement on Meat Sourcing with over USD 11 trillion in combined assets engaged with six of the largest quick-service restaurants (QSR) on the urge to analyse and reduce their potential impact on climate change, water scarcity, and threats to water quality driven by animal protein production.

Every company has now issued a public statement that they have or will set global GHG reduction targets. Furthermore, five of the six companies have now set or committed to setting targets to reduce emissions as approved by the Science-Based Targets initiative (SBTi), thus aligning with the Paris Agreement.

Engagement on the E vs. engagement on the S

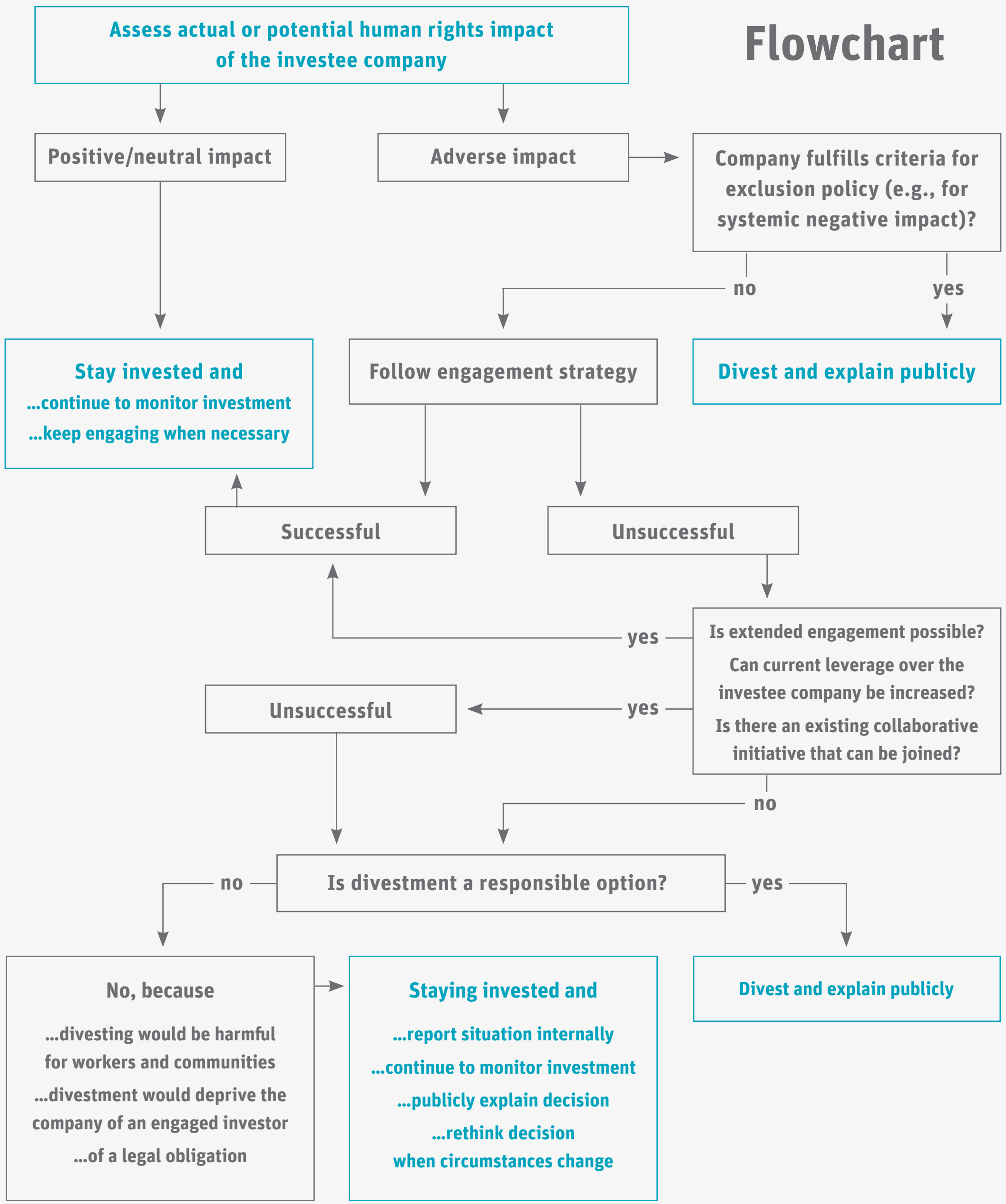
We see that an advantage of the E in ESG is that investors and companies can commit to **global and quantifiable goals** such as achieving net-zero emissions or coal exits by 2030 in OECD countries and 2040 worldwide. This alignment on clear and measurable goals is missing in the field of human rights. This is because goals in the E are easier to define and measure. Therefore, until means to better measure investors' and companies' impacts on society are found, ***meaningful* engagement with companies on their human rights due diligence processes is especially important to drive respect for human rights.**

Divestment vs. engagement

What about divestment? Can it be considered a key tool to foster change? If so, where should the line be drawn between divestment and engagement?

The OECD provides investors with a guiding question to be asked before deciding to divest: **When is divestment responsible and when can it be harmful?**[22] Answering this question can be challenging as measuring and comparing the outcomes on workers' or communities' rights in the two potential situations ("business as is" and "divestment") are not easy tasks. Still, efforts should be made to try to answer this question as part of an escalation strategy where divestment is the last resort. The following flowchart (Graphic 3), which draws primarily from the OECD Guidance,[23] illustrates a guiding overview of a decision-making process.

22 OECD (2017): Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, p. 39



Flowchart sources: OECD (2017): Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, p. 39 ff.; INVESTOR ALLIANCE FOR HUMAN RIGHTS (2020): INVESTOR TOOLKIT ON HUMAN RIGHTS, p 33; PRI (2020): Why and how Investors should act on human rights, p. 15.; UN (2011): Guiding Principles on Business and Human Rights, p. 22.

A study has analysed "exit" (divestment) versus "voice" (engagement practice with a focus on voting) based on moral considerations and on the consequences investors' decision to divest or stay engaged has on the well-being of others.[24] The finding is that, in a competitive world, divestment is less effective than using the voice, especially for institutional investors with large proportions of shares or for socially responsible investors that collaborate.

23 OECD (2017): Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises, p. 39-41, IAHR (2020): Investor Toolkit On Human Rights, p 33, PRI (2020): Why And How Investors Should Act On Human Rights, p. 15, UN (2011): Guiding Principles on Business and Human Rights, p. 22 24 Broccardo, Hart and Zingales (2020, revised December 2020): Exit Vs. Voice. European Corporate Governance Institute – Finance Working Paper No. 694/2020.

Which elements can contribute to making engagement meaningful?

Graphic inspired by OECD (2018): OECD Due Diligence Guidance for Responsible Business Conduct

Having seen that a set of elements indicate that engagement can foster change, the next questions are: Does it apply to all engagement practices? Are there specific elements that can lead to a more *meaningful* engagement?

In this context, we consider *meaningful* engagements to be those that can create a real impact. This means that the engagement promotes changes in the investee company so that the risk of negative human rights impacts connected to the company's business activities is reduced.[25]

Companies are expected to respect human rights. To do so, they must conduct due diligence throughout their value chains with the goal of preventing and mitigating human rights risks. If negative impacts occur, companies have the responsibility to provide remedy or contribute to remediation efforts.

When investors influence investee companies to manage human rights risks and impacts in line with international standards, they are making a positive impact on society and, therefore, we consider the engagement to be *meaningful.*

So, what elements make engagement to be those meaningful and effective? In Table 3, we propose a set of elements that financial institutions should take into account in order to make their engagement efforts meaningful and effective.[26]

25 This definition of "meaningful engagement" mirrors previous definitions of "investor impact" and "company impact" proposed by academics in the context of sustainable investment. Those definitions describe investor impact as "the change that investor activity achieves in company impact," and company impact as "the change that a company's activities achieve in a social or environmental parameter." Kölbel, Heeb, Paetzold, Busch (2020): Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact. Organization & Environment, Volume 33, Issue 4, pages 554–574.

Table 3: Elements of meaningful engagement [27]

Element	Explanation
Prior research about the company and its reality	Being well-informed about the company itself and its engagement history allows financial institutions to understand the **company's reality, its maturity regarding human rights, corporate culture, and willingness to improve its human rights performance.** In some contexts, **field visits** might be relevant so that engagement teams gather a **real understanding on the ground** and are better prepared for the engagement process. Prior research furthermore enables financial institutions to set **realistic goals** in line with the company's reality and ask the right questions. Companies find being in a dialogue with a financial institution that is not well-informed very challenging. Useful sources to get started are, for instance, the company's CSR reports, the ESG data of service providers, the dashboards of the Business & Human Rights Resource Centre, the Corporate Human Rights Benchmark, further sector-specific benchmarks (e.g. Know-TheChain, Oxfam Supermarket Scorecard), and dialogues with stakeholders.
Human rights expert/team	Financial institutions should have a **human rights expert or team** that, together with the financial analysts, leads the engagement process and enters into a dialogue with companies. Engagement is much more likely to be successful if financial institutions show a proper understanding of social and human rights issues, how businesses can be connected to them and what their responsibility is. Additionally, capacity of the diverse internal actors (i.e., financial analysts, leadership and the board) in human rights is key to improve integration of human rights within decision making processes.

26 Our recommendations are based on interviews we conducted with experts and on desktop-based research, e.g. Wagemans, van Koppen and Mol (2018): Engagement on ESG issues by Dutch pension funds: is it reaching its full potential? Journal of Sustainable Finance & Investment, Volume 8, pages 301-3022. Schwartz-Ziv (2021): How Shifting from In-Person to Virtual-Only Shareholder Meetings Affects Shareholders' Voice. European Corporate Governance Institute – Finance Working Paper No. 748/2021. PRI (2018): A practical guide to active ownership in listed equity, p. 9, 36-37; PRI (2018): How ESG engagement creates value for investors and companies; ShareAction (2021): Point of No Returns Part V – Leading Practice: A guide to current leading practices by asset managers on responsible investment; Candriam Academy webinar "Candriam Academy ESG Talks - Active Ownership: Is it all just talk?", Webinar: RC:ESG Investor Insights series - A Teach-in with investors: Investor Engagement. 27 Ibid.

Prioritisation in line with the UNPGs	To respect human rights and prioritise actions, the risks to rights-holders need to stand at the forefront of any risk management system. Financial institutions need to prioritise the investee companies and the topics they want to focus on the engagement strategy. For that, it is key that the prioritisation methodology is in line with the UNPGs. This means that the risk to people and the severity of the (potential) impact are the key elements to be considered. Attention should be given to not prioritise actions primarily according to the risk to businesses.
Stakeholder engagement/ Independent advisory board	Financial institutions should engage with a company's key stakeholders to **understand their needs** and include those needs in the prioritisation of engagement efforts. Financial institutions may, for instance, consider having an **independent advisory board** made up of external stakeholders and experts on business and human rights that helps them deciding when and how to engage and when to divest. Additionally, financial institutions can recommend investee companies to set up their own advisory board of independent experts. This will also improve stakeholders' voices to be heard.
Clear, realistic and meaningful long-term targets, short and mid-term milestones and defined timelines	Financial institutions should define which outcomes they wish to achieve with the engagement practice. Based on that and on the maturity level of the company, **set meaningful, realistic and clear goals and milestones.** Specific timelines with interim milestones help guide the engagement process. Meaningful targets go beyond ***whether*** the company has set up specific processes to asking ***how effective*** they are. For instance, it is important to know whether the company has a human rights policy, but it's even more important to check whether the policy is aligned with international standards and was signed off by the CEO of that company.

Measuring and monitoring of outcomes of due diligence efforts	Keeping track of the results ensures that the focus on the goals does not get lost and depicts the progress made. Whereas financial institutions should ask companies to develop and implement systems to measure **outcomes for people,** financial institutions themselves should measure and monitor the **outcomes of companies' due diligence efforts.** The latter can be done through own monitoring systems, which can include KPIs and specific questions about the quality of due diligence efforts; dialogues with companies and stakeholders; company disclosure; credible media reports; NGO reports; ESG data service providers; and/or benchmarks that include indicators that reflect the outcomes of due diligence efforts.
If needed, increasing leverage by collaboration	Increasing the influence, e.g. by joining multi-stakeholder initiatives and/or joining or forming investor-led networks and engagement initiatives, will make engagement requests more credible and urgent for companies. Collaborating with a local investor can also facilitate dialogue between companies and investors.
Participation in peer-to-peer and multi-stakeholder platforms	Participating in platforms such as the Workforce Disclosure Initiative, Dutch Pension Funds Agreement on Responsible Investment, Global Network Initiative, or initiatives such as Roundtable on Sustainable Palm Oil, helps to connect with other investors, exchange experiences, hear stakeholders' views, and broaden engagement possibilities.
Ongoing and constructive dialogue	The dialogue with the company should be ongoing throughout the whole engagement process. In-depth, well-prepared meetings are considered especially effective, as opposed to questionnaires that are perceived as time-consuming by investees. Communication with the different teams and independent directors, motivating management leadership to join meetings and speaking at shareholder meetings is important throughout the engagement process to achieve positive outcomes.

	Virtual-only meetings tend to be shorter and dedicate less time to shareholder concerns. **In-person meetings and on-site visits** can facilitate dialogue and understanding of the actual situation. **Cultural proximity** can also enable effective engagement. External stakeholders should be considered during the dialogue process as well. A **constructive language** should be used whenever possible, so that confidence and trust is built between actors and companies do not get defensive. Strong, long-term relationships between financial institutions and investees enable increased trust, knowledge sharing and, consequently, more meaningful engagement.
Clear, transparent escalation strategy	Financial institutions should not stay engaged forever if there is no sign or willingness for improvement. A clear escalation strategy should outline the steps taken **in case of unsuccessful engagement,** provide timelines and/or triggers for escalation and be integrated into wider stewardship reporting. Following through with the escalation strategy if the results are not as agreed upon is crucial to stay credible. An **escalation strategy** can include contacting the board and expressing concerns, either by writing a letter, at conference calls or at a shareholders' meeting; issuing a public statement; increasing leverage by collaborating with other financial institutions; voting against board members at annual general meetings, voting against the annual financial report; voting against the re-election for directors responsible for the topic at hand; (co-)filing shareholder resolutions; submitting one or more nominations for election to the board; seeking legal remedies; and/or as a last resort, reducing exposure in the company or completely divesting, even if it is just temporarily until the company has improved its practices.
Transparent communication and reporting about engagement	Communicating transparently about engagement processes helps customers **understand financial institutions' efforts and increases the financial institutions' credibility and trustworthiness.** In addition, it gives companies a first glimpse of the type of engagement processes to expect.

The case studies in Box 5 and Box 6 illustrate two examples of how financial institutions engage with investee companies and clients.

Box 5:
Case study ABN AMRO

ABN AMRO engages reactively with companies whenever there is a serious breach of the Ten Principles of the UN Global Compact, but also proactively in connection with certain topics that help prevent potential violations and also inspire companies in a positive way. The company carries out high-intensity engagement with corporate clients when it detects a non-compliance with its standards.

First, the bank's Engagement Committee determines the engagement potential and approach based on input by the client relationship manager and the risk assessed by the sustainability expert at its credit risk department. A decision to divest may have already been taken at that stage depending on the client's ability or willingness to improve. Next, clear objectives of engagement, remedial actions, and deadlines are defined in an engagement memo which is distributed to the client along with the information on consequences of non-compliance. Achievements are monitored, often on a daily basis. Lastly, engagement results are evaluated. If engagement objectives are not fully achieved and successful engagement is not possible, the relationship with the company is ended.

Box 6:
Case study Platform Living Wage Financials (PLWF) and its evolving assessment methodology

The PLWF is an alliance of 15 financial institutions with over EUR 2,6 trillion of assets under management. The initiative started as a bottom-up initiative, meaning that it started as a small group that did not rely on the strength of numbers, but rather focused on the goals to achieve and opened it up for other financial institutions to join. The initiative's aim is to achieve a living wage in global supply chains of the investee companies. It does so by using a methodology that closely follows the UN Guiding Principles Reporting Framework.

It is conducting its own research on living wages and has been monitoring garment companies since 2017. An accountancy company has supported the initiative with drafting the methodology. The methodology is adapted over time to new standards and expectations in order to nudge companies to continuously improve. This is done by, for instance, changing the weighting of the questions in the assessment questionnaire or by adding categories.

ASN Bank, for instance, assesses up to 15 investee garment companies based on annual reports and website, and the accountancy firm provides feedback on the results.

Conclusion and recommendations

The transition from voluntary initiatives to legal requirements on conducting human rights due diligence is setting a new standard for financial institutions to fully integrate human rights within responsible investment strategies.

As mentioned, engagement is a key tool for financial institutions that seek to prevent and mitigate adverse human rights impacts, using their leverage to influence the investee companies and clients.

Fostering human rights in business is a multi-stakeholder space in which investors play a big role – even small financial institutions and minority shareholders. Every financial institution can *effectively* contribute to a positive impact by, for instance, engaging by letter, teaming up with other investors, and/or advocating for responsible policies. It is not about *whether* a financial institution can drive change within a company, but about *to what extent* it can do so. *Effectiveness,* in this case, relates to what a company could be doing, meaning that financial institutions should maximise their individual impact potential when engaging with an investee company.

In this study we conclude that there is a clear potential for engagement to foster change in the corporate culture of investee companies and their capacity to manage human rights issues. For that, the quality of the engagement practice is key.

In summary, we recommend that financial institutions adopt the following practices to make their engagement as meaningful as possible:

- → Conduct research on the company's reality and maturity level prior to engagement
- → Establish a human rights team to build internal capacity and expertise
- → Conduct prioritisation for engagement in line with the UNPGs
- → Engage with investee company's key stakeholders to understand their needs
- → Set clear, realistic and meaningful long-term targets, short and mid-term milestones, and defined timelines
- → Ask investee company to develop and implement systems to measure outcomes for people, meanwhile measure and monitor the outcomes of companies' due diligence efforts
- → Increase influence by joining multi-stakeholder initiatives and joining or forming investor-led networks and engagement initiatives
- → Participate in peer-to-peer and multi-stakeholder platforms
- → Ensure an ongoing and constructive dialogue with investee company
- → Have a clear and transparent escalation strategy
- → Ensure transparent communication and reporting about the engagement practices

Improving outcomes for people should be the ultimate goal of any engagement. However, it is well-known that measuring the actual outcome for people continues to be a challenge. While financial institutions might not be able to do so, they can measure and monitor the outcomes of companies' due diligence efforts. At the same time, financial institutions should not lose focus on the need to measure the outcome for people. For that, financial institutions should ask companies to develop and implement systems that allow for this measurement to take place. Additionally, financial institutions can partner up with other financial institutions and stakeholders to develop and implement measuring systems that grasp the outcomes of effective due diligence efforts.

Finally, sharing best practices, knowledge, and experience with companies and other financial actors is important to help companies understand the human rights management level they can and should reach and how to reach it, and for financial actors, to increase the learning curve and foster more meaningful engagement in the future.

Annex I: List of interview partners

In order to complement the findings from our desktop research, we conducted semi-structured interviews with five finance industry experts.

We thank the following interview partners for their insights:

- Investment expert at ASN Bank
- Sustainable finance expert at ASN Bank
- Expert on social issues at the Principles for Responsible Investment
- Finance expert in UNGPs 10+ Project of Working Group on business and transnational corporations and other business enterprises
- Engagement expert at Sustainalytics

Annex II: Advantages and disadvantages

Table 4: Advantages and disadvantages of direct, collaborative, and outsourced engagement [28]

Level of engagement	Advantages	Disadvantages
Direct engagement	• Financial institutions can follow own specific goals without making compromises • One-to-one dialogues tend to be more productive • Builds a long-term relationship between companies and financial institutions	• Can be costly • Companies need to coordinate different requests from different financial institutions
Collaborative engagement	*Prerequisite: good preparation, common and specified goals, committed resources and a clear common escalation strategy* • Increased leverage: “strength of numbers” • Unified voice leading to a more informed and constructive dialogue • Build and pool knowledge and skills, share risks and costs • Increased legitimacy • Give internal stakeholders at company more power to drive change	• Alignment on interests can be challenging, also considering the different amounts of holdings financial institutions have • Might need to compromise on certain goals • Coordination of real-time interactions can be challenging • If not coordinated well, financial institutions might end up engaging on their own instead of as a group

Outsourced engagement	*Prerequisite: financial institutions need to clearly define their expectations on engagement (and voting) activities and develop criteria to assess external providers during the selection* • Makes it possible to scale engagement even when no internal teams are available. This is especially relevant for financial institutions with large portfolios	• Need to ensure alignment of policies with asset manager or service provider • Less personal dialogue, little to no direct interaction with investee company • Reduced learning dynamics for financial institutions

28 Main elements from interviews with experts, and PRI (2013): Getting started with collaborative engagement, PRI (2018): A practical guide to active ownership in listed equity, p.39-40