Episode 29: 20 Years of Engagement Transcript

Vicki Bakhshi: Engagement, really it's about a theory of change, is how I see it, is that we're having dialogue with companies, and we're looking for them to change, and we need to figure out, what are the levers that are best going to achieve that? And it definitely takes persistence over a period of time to do that. It's not something we achieve through sending a single letter or having a single meeting.

Michael Torrance: Welcome to "Sustainability Leaders." I'm Michael Torrance, Chief Sustainability Officer with BMO Financial Group. On this show, we will talk with leading sustainability practitioners from the corporate, investor, academic and NGO communities to explore how this rapidly evolving field of sustainability is impacting global investment business practices and our world.

Jonathan Hackett: I'm Jonathan Hackett, and welcome to "Sustainability Leaders." My colleagues in BMO Global Asset Management are celebrating 20 years of investor engagement in 2020. They have recently published a paper looking at their experience during those first 20 years, providing an overview of the responsible investing industry from the eyes of an active investor in companies around the world. Today, I'm joined by Vicki Bakhshi, a Director in BMO Global Asset Management's Responsible Investment Team, to discuss these past 20 years of engagement and to look forward to what the next 10 years will look like. Welcome, Vicki, and thank you for joining me today.

Vicki Bakhshi: Thanks, Jonathan. It's great to be speaking to you.

Jonathan Hackett: Starting from the basics, how would you describe the cost of engagement, and what does it really mean as practiced by your team?

Vicki Bakhshi: So engagement is really about communication simply. It's dialogue that we as investors have with the companies that we invest in. Our team focuses on dialogue and conversations about environmental issues, social issues and corporate-governance issues. The reason we do this really is thinking about ourselves as an owner, not a trader. So shareholders are the owners of a company, and one way of thinking about that sort of trading model is that we just buy a share and wait for the returns to come in, and we think of it differently. We think if we're owning a company, if we're a shareholder in a company, that comes with rights, but it also comes with responsibilities. So the whole idea of engagement is to work through conversations with companies through letters, phone calls, meetings, e-mails, open up the channel of communication with companies and work in partnership with them to make them better. So really our team works to identify the weak spots, whether that be in the way they manage their greenhouse-gas emissions, what they're doing around human rights, their corporate governance. We work to identify where companies could do better, open up a discussion with them and hopefully between us work out a way that they can improve.

Jonathan Hackett: So it's safe to say that the investment industry hasn't always approached it this way. I'd be interested to hear your experience. As someone that joined BMO GAM 14 years ago, what did engagement in the investment industry look like when you first joined?

Vicki Bakhshi: Yeah, for sure things were really different back then. So I joined 14 years ago, and I'd worked before then on climate change, so I worked back in the day when Tony Blair was the UK Prime Minister, I worked in the Prime Minister's Office on climate change, and then I worked on the "Stern Review" looking at the economics of climate change, and that was really when climate change was seen as quite a niche environmental issue and not the issue it is today. And when I joined BMO, I think really responsible investment and engagement was seen as something that was quite a niche thing to do, and it was all just really to do with ethics and not something that was relevant to mainstream investment is really how it was seen back then, and I think that's because of the history of reasonable investment, so if you look back, right back to the early days of responsible investment, it was really all about mission-driven investors and campaigners using this as a tool to achieve ethical objectives. So just to sort of tell a story about that, if you look back to one of the very earliest cases of shareholder activism, it was back in the '60s when some campaigners bought shares in Dow Chemical Company. The reason for that is one of Dow's products was napalm, and that was being used in the Vietnam War, and there was a long battle between these shareholders who were trying to get a shareholder resolution on the agenda of that company at its AGM asking them to stop napalm sales for military purposes, a long battle, and eventually they did get it on the ballot. That's the kind of early history of responsible investing, and I think when I joined 14 years ago, that was still the perception of what the purpose of thinking about these environmental, social and governance issues were, that it was a kind of niche, ethical thing. And the reason I joined BMO and the reason I was interested to join them is that really they were one of the first investors to appreciate the environmental, social and governance issues aren't just ethical issues. They're also financial issues, and so they set up the engagement program before I joined back in 2000 with a view to engage on these issues because they thought that that was actually important from a financial point of view and as a legitimate investor tool.

Jonathan Hackett: Vicki, within the report, you share some really interesting data and analytics around your engagement approach. Looking back across that data, how has the set of ESG issues that sat at the top of the engagement agenda evolved?

Vicki Bakhshi: Yeah, the report we published has got a load of that data in it. We've got data on over 5,000 companies that we've engaged since the beginning of the engagement in the year 2000 and going on for 4,000 instances of change that we have achieved through that engagement over that time. Looking back at the early days, and we actually dug out some of the old documents that we published right at the beginning in 2000 when we started doing engagement, and at that time, we had five engagement topics that we prioritized: climate change, environmental management, human rights, forestry and disclosure on environmental and social issues. We've added more to that over time, but I think all of those remain as relevant today as they were back in 2000. I would say in the early days I think there was more focus on reporting and disclosure by companies because when I first started, a big part of the problem that we had was just finding relevant information. You really had to dig in company websites. There wasn't much disclosure of data or information on how companies were managing ESG issues. That has moved on a vast amount in the last 14 years, so we've been able to widen out our focus, not just to asking for data and disclosure, but to actually asking companies to take action and set strategies.

Jonathan Hackett: As we sit 6 months after COVID-19 was declared a pandemic, people are talking about how the financial and economic stresses we are experiencing will impact ESG and responsible investing. At the same time, though these stresses are unprecedented, looking at the 20 years that this report covers, it includes a global financial crisis. What kinds of effects did that crisis have on ESG and the asset-management industry?

Vicki Bakhshi: So I joined BMO just before the financial crisis, which was spectacular timing. It was something that really ... It shook up the global economy, but it also shook up the asset-management industry and the way people thought about engagement and about ESG issues because after the financial crisis when regulators and the media and the public were looking to figure out what caused it, one thing that happened is that fingers were pointed at shareholders, and people said, "Well, hang on a minute. These guys owned the banks. Why weren't they keeping a closer eye on this? Why didn't they ask management about the risks they're taking? Why didn't they look at the kind of incentives that were provided to the executives of these companies?" And so there was a lot of soul searching after the financial crisis about the role of shareholders and what they should've done, and we and others engaged a lot with financial institutions after the financial crisis to make sure they were really addressing some of the root causes behind it, that they were looking at their governments, that they were changing their pay structures, that they were making changes to their culture, and we really wanted to hold their feet to the fire and check that they were actually going to do what they said they were going to do, and we had numerous meetings with board members of the likes of HSBC, Barclays, RBC to ask them to do more to kind of learn the lessons of the crisis. As well as investors, regulators were looking at this as well and asking themselves this question. Why didn't shareholders do more? And that was one of the things that in 2010 led the UK to publish the UK Stewardship Code. That code was the first formal guidance from a big financial-market regulator which was attempting to set up best practice on how shareholders should behave as owners, how they should do engagement and proxy voting, what kind of things they should disclose around that, and that Stewardship Code has formed the blueprint for similar codes that have been published in other markets ever since that was out in 2010.

Jonathan Hackett: Thanks, Vicki. This report paints a great picture of the evolution of engagement over the last 20 years. What do you think defined the last 10 years that we've just wrapped up compared to the 10 previous to that?

Vicki Bakhshi: I think the 2010s was when responsible investment generally and engagement in particular really went mainstream and really took off, and you can see that in many, many ways, for example, the expansion in the membership of the Principles for Responsible Investment. We were a founder member along with a handful of other firms when it first launched in 2006, and now at the end of decade, it's got well over 2,000 signatories. I think the main driving force behind that expansion was that finally the penny dropped. These ESG issues were actually important from a financial point of view as well as an ethical point of view. Also, there was an expansion of regulation and, I think, also just an increase in expectations from the clients of asset managers that we should be doing more on this. So that mainstreaming has resulted in changes to the way engagement happens. There's a lot more collaboration than there used to be. So when I first started, typically we were talking one-on-one with companies, and there wasn't really anyone else engaging with them. Now we're often talking as part of a group of investors. Engagement over the decade also expanded in scope, so it went more global, more engagement with emerging market companies as well as sort of in local markets and also across asset classes, so this isn't just about shareholder although that's important. Also, we engage with companies who issue bonds because if we've bought a bond in a company, we're lending that company capital, we're lending it money, we've got a relationship with that company, and we think engagement is just as legitimate there as it is with shareholders. So we've seen a sort of expansion in the scope and the breadth and the depth of engagement as it's become more mainstream.

Jonathan Hackett: BMO GAM has over 20 years experience engaging with companies. Over those years, what have you learned makes engagement most effective? Going through all the effort in having these conversations, often charted across multiple years, what gets things across the line and leads to the results that you're after?

Vicki Bakhshi: Yeah, we've put a lot of thought into this, and engagement, really it's about a theory of change, is how I see it, is that we're having dialogue with companies, and we're looking for them to change, and we need to figure out, what are the levers that are best going to achieve that? And it definitely takes persistence over a period of time to do that. It's not something we achieve through sending a single letter or having a single meeting. Like you were saying, it's something that happens over time as we build that relationship. And I think it depends on a few things. So first of all, what are we engaging on? So I said before about the link between ESG and financial performance. So when we select, okay, what are we going to be talking to this company about, we're really trying to always link ESG back to the business case and put the case to companies about this makes sense for you as a business, as a forward-looking business to be thinking about this. And we also look to prioritize a relatively small number of key messages or questions. We try not to go to companies with a long laundry list of all of the things they could be doing wrong. Companies got limited capacity. We really try and focus in on the most important. Then there's a kind of how we do the engagement, so once we've opened up that dialogue, how do we make that as effective as we can? Well, we try and aim where we can for the decision-makers in a company. We try and aim for dialogue at board level where it's possible to do that. We try and build a relationship of trust over time with companies because we think it does take that persistence. We need to be aware of some cultural differences. We've got ... Our team is very multinational. We've got people from different backgrounds with different languages because we recognize that, for example, in the UK has a long history of investor stewardship. In other countries, that's not necessarily the case, and so we have to sort of introduce companies to this idea of dialogue about these environmental and social-governance issues and appreciate they may be a different place to companies who've been doing this for a long time and bring them along the journey with us. And then we also like to bring to companies ideas of, what are your peers up to? We find that's a really powerful tool for change. If companies feel they're falling behind their competitors, then they will sit up and take notice. And then once that engagement has happened, how do we respond? I think on the one hand, we have to be prepared to escalate if things aren't working, so if we're keeping on having the same conversations and getting the same responses from companies and we're not making headway, we have to think about, well, how do we actually escalate this? Because it's not working. One example being we might choose to vote against one of the board of directors at the annual general meeting, which is something we're doing now with companies that we don't think have got a good enough approach on climate change. And on the other hand, we ought to praise positive performance and practices, and we shouldn't just be about asking companies more, more. I think we have to recognize when there are leaders when companies have done well. I think it's really important to reflect that and acknowledge that so that we can bring the rest of the market along with them.

Jonathan Hackett: I think you alluded earlier to collaboration is a way that engagement has changed, and that's something that we've spoken a bit about on prior episodes of "Sustainability Leaders." How do you think collaboration has changed over the years, both in terms of the quantity of collaboration and in the participants?

Vicki Bakhshi: There's certainly more collaboration as engagement has become more mainstream. One example of that at the moment is the Climate Action 100 Initiative. That initiative now represents over $47 trillion of assets in terms of the investors who are involved in that. It's engaging intensively with the 161 companies, which include the world's largest emitters, and asking them to set business plans which are in line with The Paris Agreement. So that's an example of the sort of scale of collaboration that we wouldn't have thought was possible back when I first started on this. But also, as you said, who we collaborate with is important, and some of these big sustainability issues are too big just for one group to tackle on their own, and increasingly we're looking to partner not just with other investors but also with other stakeholders where they've got great insights that we can use to really inform our engagement with companies, so to give one example of that, we look at supply-chain labor standards as one of our engagement areas, and we think that's often where some of this are the worst instances of things like forced labor and child labor can happen, and the brands at the top of the chain can do a lot to wipe out those practices. We make use of research from an organization called KnowTheChain, who do fantastic in-depth research on where the worst supply-chain practices are, and we use that to go back to companies and highlight some areas where they can do better.

Jonathan Hackett: Thanks, Vicki. Having covered off the last 20 years in the report, I wanted to ask you to speculate as to what the next 10 might look like. What do you think a retrospective on engagement will look like at 30 years?

Vicki Bakhshi: Well, I think there's a really interesting shift going on right now in the purpose of engagement. So as I said at the beginning, really engagement started off as being about ethics and then moved on to being about value and valuations and linking those environmental, social and governance factors to financial performance and materiality, and I think actually in the next 10 years in relation to engagement and responsible investment in general, we're moving to a third phase so from values to valuation and now, I think, to impact, and I think if you talk to people, back at that dinner-party example, if you talk to plan about responsible investment, about the kind of things our team does, talking to Amazon about labor standards or talking to China's largest coal miner about climate-change policy, I think what people are really interested in is not necessarily how that protects their risk-adjusted financial returns but actually the fact that their money can do good, and that's a really exciting idea, and people want to, I think, understand what impact their money can have and how that engagement has not just financial returns but also social and environmental returns, and that's a shift that we're seeing really strongly coming through from our clients, and that's something that's feeding into our engagement, and we're looking now at this sort of dual purpose of engagement, pursuing financial returns alongside sustainability returns, and practically speaking, how we're doing that is looking at the Sustainable Development Goals, which are the 17 goals for a more sustainable world by 2030, and looking at how our engagement can support those SDGs and reporting to our clients about that. In terms of the actual ESG issues we're looking at, I mentioned some of the issues that we looked at right in the very early days of engagement. Like I said, maybe not so much has changed since then in terms of those are still important issues today. I think there's sort of two things that really stand out that I think are going to be big, big priorities for next 10 years. One without a doubt is climate change. So we know from the Intergovernmental Panel on Climate Change's report on 1.5 degrees that if we're going to limit the global temperature rise to 1.5 degrees, we need to roughly halve global greenhouse-gas emissions between now and 2030, so that's a historical shift in terms of decarbonizing the global economy, and a shift of that magnitude needs all stakeholders to work together, and we and others working collaboratively will be continuing to focus on climate change in the decade to come. And the second one I wanted to pick out is social issues, and I think if people think about the sort of E,S and G, the S has sometimes perhaps in the past been rather neglected. It's ... And part of the reason for that is, it's quite hard to measure, but I think the COVID pandemic has really brought it home how important those social issues are, and we've seen this sort of great gap between companies that have treated their staff, their stakeholders, their customers in local communities well and those who haven't, and some of them have been called out in the media for that, and that, I think, for us heightens the focus that we already had on social issues, and that's something that will be a focus area for us, getting companies to disclose better on those through initiatives like The Workforce Disclosure Initiative, engaging with them to treat their staff fairly and also to, as I mentioned before, look right through their supply chains to see what kind of labor practice they're having there.

Jonathan Hackett: Vicki, thank you for sharing your insights and the conclusions from this most recent publication. One last question for you. As someone who's worked in the industry for some time, I'm curious to know what you would consider to be a lasting impact of the time that you've spent engaging with companies and working with them from a perspective of responsible investment?

Vicki Bakhshi: Yeah, I've been doing this for 14 years now, and I still get excited about this job, and I get excited when I hear that a company has changed what it's doing, and it's doing something that we had asked it to do and that actually these video conferences that we're having, these letters that we send, they're actually having an impact in the real world, and they're improving the environment, or they're improving people's lives, and that still gets me excited, even after all this time. And I think the legacy, I hope, of what I do and what my team does is to really make everyone understand that they've got choices about the way that their money is managed because I think we're so much more aware. It's amazing to me how much more aware that we are about environmental issues than, like I said, when I was working on climate change back in the day, and this was a really niche issue. We've moved on so far in our understanding, and people are making better choices and more conscious of this, but I think still there's too many people that don't get that actually the biggest power that they have is where they put their savings or their pension. I would absolutely love the legacy of what we do is for people to really get that their money can do good.

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