Stewardship Codes and the Pursuit of Corporate Sustainability

Abstract

Stewardship codes are a relatively new phenomenon in corporate governance designed to encourage institutional investors to become more active and responsible shareholders. In the years since the United Kingdom introduced its stewardship code in 2010, around twenty other jurisdictions have followed suit. It is highly likely that stewardship codes will continue to proliferate across the globe in much the same way that corporate governance codes have since the 1990s.

This paper examines the nature, purpose and likely effectiveness of stewardship codes. The concept of investor stewardship raises many questions, both practical and theoretical, which are explored through an analysis of existing codes. How is it envisaged they will work; is stewardship likely to be feasible in practice; and what does it mean for the role of boards of directors of listed companies?

Perhaps most importantly the article considers the potential for stewardship codes to promote corporate responsibility. Human society is facing some very serious challenges in terms of sustainable development. If corporate law and regulation is to become truly great again it needs to help rather than hinder corporate efforts to pursue long-term goals over short term gains. In the absence of more solid law reform, stewardship codes provide a tool that can help tip the balance towards sustainable value creation.

Introduction

Stewardship codes contain recommendations about how large investors such as pension funds and insurance companies ought to play a role as active and engaged investors in listed companies. The United Kingdom regulator has described stewardship activities as including: ‘monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure and corporate governance, including culture and remuneration’.1 The Singapore code refers to monitoring and engaging on issues such as ‘the mandate for the board, performance and performance management, risk management, capital structure and corporate governance’.2 Thus the focus of stewardship is very broad and primarily concerns the process of engagement between companies and their investors rather than the topics covered. However many codes also refer to environmental and social issues and, in its most recent review, the United Kingdom regulator notes

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the increasing discussion of these issues in stewardship statements. Thus it may be that this heightened communication between investors and companies will help support corporate strategies that embrace sustainability and corporate social responsibility.

Most stewardships codes are voluntary in nature, falling into the category of soft rather than hard law. The Danish code is one of the few codes that gives reasons for the choice of soft law, explaining how it is able to reflect ‘best practice’ and is more flexible and dynamic than traditional legislation. Other codes describe themselves as ‘principles-based’ drawing on regulatory theories that predict that principles can be more effective than precise rules in complex situations. Many codes employ a system whereby investors can choose whether to sign up to the code and if they do, they are then expected to make certain disclosures about their investment policies. They use the same mechanism as corporate governance codes in that they ask signatories to ‘comply-or-explain’ with the code’s principles. This means that the primary obligation is for an investor to be transparent about its approach to stewardship rather than to comply with all of the code’s principles. Common principles contained in stewardship codes deal with monitoring and engagement policies; conflicts of interest; collective action; voting policy and disclosure of voting activity. They ask investors both to create and implement policies as well as to publicly disclose information about those policies.

Global spread of stewardship codes

At the time of writing at least twenty countries around the world have introduced a stewardship code for institutional investors and more are likely to follow suit. Table 1 details the countries that have a code in place as well as the code issuer and mechanism of implementation. In many jurisdictions these stewardship codes have been introduced by corporate governance regulators as a complement (or a potential fix) to their corporate governance codes, for example the UK, Japan and Denmark. In other jurisdictions, such as Canada, Malaysia and Brazil, they have no regulatory backing and are voluntary industry initiatives. Codes can switch between these categories depending on the level of government support. In the UK the stewardship code began as an industry initiative and was then adopted by the regulator whereas in South Korea, due to strong opposition

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to a formal code, a regulator-initiated code was effectively downgraded to a voluntary private initiative.6

As well as national stewardship codes, there is considerable action around investor stewardship at an international level. The International Corporate Governance Network (ICGN), a member-based organisation for governance professionals, has been taking a lead in terms of following and encouraging the development of stewardship codes. Building on twenty years of policy work, in September 2016 it published the ICGN Global Stewardship Principles with the aim of providing an overarching model for best practice stewardship. Most codes recognise the existence of other national and international codes and accept that disclosures should complement each other rather than confuse.7 This is increasingly important in a globalised market where foreign investment forms a large part of most share markets. This is nicely put by the Dutch code (issued by investor association, Eumedion) which lists the key international initiatives explaining that:

A large degree of similarity between these different sets of best practices is also desirable, because more than 70% of the shares in the largest Dutch listed companies are held by non-Dutch parties and conversely, many Dutch Eumedion participants also hold shares in non-Dutch listed companies.8

**Stewardship as a wider concept**

Stewardship is a concept familiar to the discipline of management studies, particularly in the area of leadership but also corporate governance.9 Stewardship theory has been used as a contrasting approach to agency theory to better understand the way in which business leaders and company directors behave in practice.10 Agency theory, based in economics, considers humans as rational actors seeking to maximise personal benefit. As the dominant theory behind corporate governance, it explains the need for legal structures and governance practices that encourage monitoring of managers by a board of independent directors to ensure they do not misbehave. Corporate governance is seen to be about reducing agency costs (the detrimental effect of managers pursuing their own agenda rather than that of the company). In contrast, stewardship theory draws on psychology to explain the fact that managers do not always exhibit self-interested opportunistic

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behaviour, instead they are often found acting collaboratively for the benefit of the organisation. Thus the academic literature defines stewardship as ‘the extent to which an individual willingly subjugates his or her personal interests to act in protection of others’ long-term welfare’.11

Stewardship codes however, are not being applied to corporate leaders but to particular groups of shareholders, namely large, institutional investors. These shareholders are being asked to be stewards, not of one particular organisation but of all their investments. The Australian code defines stewardship as ‘the careful and responsible management of something entrusted to one’s care. The Brazilian code applies this to the context of investors stating ‘stewardship embodies the careful management and monitoring of securities owned by the end beneficiaries’.12

Stewardship codes take the concept further by recommending a set of policies and processes that make up ‘careful management’. Stewardship is thus seen as a system of ‘ownership engagement’ by shareholders. As Micheler points out, before the stewardship code company law was silent on the strategy shareholders should adopt.13 Generally company law gives shareholders many rights (to vote, to put forward resolutions and to elect directors) but it does not encourage shareholders to use these rights. The law has to some extent fallen behind the times, it assumes that shareholders are interested owners in the companies in which they invest when this is often not the case. Thus the current policy direction is to encourage greater participation by shareholders such that they engage in a responsible way to promote the long-term interests of the company.

**Responsible investment**

Work in the area of investor stewardship overlaps and supports international initiatives promoting the related concept of responsible investment. It was the United Nations in 2006 that first initiated the development of guidelines on responsible investment. The Principles for Responsible Investment (PRI) were developed by a group of industry experts and have now been in place for a decade. They are both voluntary and aspirational in nature and the number of signatories has risen from the original 63 in April 2006 to 1714 in April 2017.14 Responsible investment is a similar but somewhat narrower concept than stewardship as it focuses on the incorporation of environmental, social and governance (ESG) factors into investment decisions while stewardship also incorporates broader issues of strategy and performance. The PRI is a supporter of stewardship codes and has been welcoming stewardship developments whilst monitoring their alignment with the PRI

principles. Nevertheless, both concepts promote active ownership and collective action by institutional investors, something seen to be lacking in recent years. In many national stewardship codes, the concept of responsible investment and incorporation of ESG factors comprises one of the code’s principles. In other countries, for example South Africa, the code is centred on responsible investment with other ownership responsibilities portrayed as secondary support.

**Origins and purpose of stewardship codes**

The introduction of stewardship codes was triggered by the global financial crisis (GFC) and the consequent review of corporate governance in United Kingdom banks led by Sir David Walker. He concluded that there was ‘a need for fund managers and other major shareholders to engage more productively with their investee companies with the aim of supporting long-term improvement in performance’.16

Thus it is important to note that the concept of stewardship codes emerged as a way to improve corporate governance and was not a direct response to problems with financial markets themselves. Indeed, a stronger role for shareholders in corporate governance had been advocated by United Kingdom policy makers ever since the Cadbury report of 1992.17 It was the GFC, however, that led to institutional investors being identified as culprits: ‘absentee landlords’ failing to do anything to monitor or control wayward bank executives.18 Lord Myners in his role as Financial Services Secretary was a particularly vocal critic pointing out that institutions had become uncomfortable with the responsibilities of ownership as opposed to investment.19

Lord Myners’ comment touches on the nub of the issue: the fact that shareholders have diversified into many different categories and, in practice, many act as traders rather than owners of shares.20 This contrasts with corporate law which tends to treat shareholders as a homogenous group directly owning shares in the company and hence interested in its long-term strategy and prospects. Although there have always been a variety of different types of shareholders these differences have

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accelerated rapidly in importance in the last 40 years or so.\textsuperscript{21} The trader mentality has been enabled by technology and innovation as well as the ongoing financialisation of the economy. Hedge funds, index-funds, securitisation and derivatives markets have all changed the nature and purpose of share ownership, creating long investment chains that distance the investor from the equities that underlie their investment. In reality it is difficult to even know who owns the company’s shares which may be subject to stock lending arrangements, derivative contracts or contracts for difference.\textsuperscript{22}

It is unclear what proportion of listed company shareholders are acting as traders but it is clear that without a significant proportion of shareholders acting as interested owners, our current corporate governance mechanisms cannot function effectively. Thus one of the objectives of stewardship codes is to attempt to bolster this proportion, to tip a few more shareholders towards acting as long-term owners or stewards, rather than short-term traders. Only a few of the codes expressly state this aim, for example the Singapore code explains:

> In today’s context, the investment value-chain linking ultimate asset owners to investee companies is increasingly complex. Many countries are seeing a trend towards fragmented ownership, especially in listed companies, with many shareholders each holding a small proportion of shares. Coupled with increasingly shorter shareholding tenure, the ownership mentality is arguably being eroded and replaced by a prevalent short-term view of investment and portfolio management.\textsuperscript{23}

If we can encourage more shareholders to act as owners this ought to enable corporate decision-makers to embrace a longer-term view of corporate strategy and sustainability rather than chasing short term profit. Short-termism in financial markets is probably the most significant impediment to the pursuit of corporate sustainability. Market focus on quarterly, day-to-day or even minute-to-minute changes in share price makes it very difficult for company leaders to make decisions that temporarily compromise short term profits for long term gains.

In the European Union the problems of short-termism have resulted in amendments to the EU Shareholder Rights Directive:


\textsuperscript{22} Wheeler, “From Responsible Saver to Stewarded Investor?”

\textsuperscript{23} Stewardship Asia, “Singapore Stewardship Principles For Responsible Investors,” 3.
The new rules aim to contribute to the long-term sustainability of the EU companies, enhance the efficiency of the chain of intermediaries and to encourage long-term shareholder engagement.  

The new shareholder rights were first proposed by the Commission in April 2014 and amendments to the Directive went through a long process of debate and compromise. The final version was adopted by the European Council on 3 April 2017 and Member States have two years in which to incorporate the provisions into domestic law. The preamble to the Directive clearly identifies the problem of short termism in capital markets:

The financial crisis has revealed that shareholders in many cases supported managers’ excessive short-term risk taking. Moreover, there is clear evidence that the current level of “monitoring” of investee companies and engagement by institutional investors and asset managers is often inadequate and focuses too much on short-term returns, which may lead to suboptimal corporate governance and performance.  

The European Commission states that the average share-holding period is 8 months and, on average, fund managers turn their entire portfolio every 1.7 years. This, together with the fact that the performance of asset managers is usually evaluated on a quarterly basis, demonstrates that short-term strategies are driving corporate governance.

The Directive takes stewardship beyond soft law and gives it some legal backing. Once the Directive is implemented in Member States, institutional investors will be required to ‘comply –or-explain’ regarding their policies on shareholder engagement. The hope surrounding this, and the stewardship movement more generally, is that increased engagement will provide investors with information on long-term prospects that will tip the balance away from a short-term focus and provide incentives to invest for the long-term. The Malaysian stewardship code states:

Active engagement taken collectively by institutional investors will usher in an ownership culture that ensures management prioritises the best interest of the company at all times.

The crucial issue for future research is to investigate where the tipping point lies. We do not know what percentage of a company’s shareholders needs to act as owners for sustainability to take hold. Nor do we understand the size of holding necessary for engagement to have any effect.

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25 European Commission.
26 European Commission.
Investor behaviour

In addition, the ‘owner versus trader’ concept is highly complicated and it is doubtful that the policy behind stewardship codes has fully taken this into account. Only a few institutional investors manage their assets internally, most employ external asset managers to do this job. Some of these asset managers are independent firms and others are owned by banks or insurance companies. Traditional investors may also entrust some of their funds to non-traditional investors such as hedge funds or private equity firms. Celik and Isaksson argue that it is not the label given to an investor or its type that determines its likely ownership stance and engagement level, rather it is the business model and regulatory framework within which it operates.27 For example, in the United States, some large public pension funds have a de facto obligation to vote all share whereas in Sweden there is a public pension fund that is prohibited from voting in order to prevent government interference in the private sector.28

Another important player in the market is the proxy advisor. These organisations are employed to provide analysis and advice on voting policy and to exercise votes on behalf of the institutional shareholder. They solve the practical problem of an institutional shareholder being required to attend literally hundreds of general meetings in a short reporting season. They have come to be quite powerful as most investors tend to follow their recommendations. Several stewardship codes recognise this and encourage investors not to ‘blindly delegate’ their responsibilities but to ensure that agents act in accordance with the investor’s policies.29 Many codes also focus on improving transparency around these increasingly complex investment chains. The Danish code recommends that investors disclose any use of service providers, such as voting advisory services, and how they are used. The EU Shareholder Rights Directive also targets proxy advisors, making them subject to transparency requirements and a code of conduct.

In short, the chances of a stewardship code increasing ownership behaviour in any particular jurisdiction will be partly dependent on the structure and legal framework of the local investment market and the power of the different market players. Nevertheless, with huge flows of investment monies now flowing internationally, there will also be a foreign influence in most markets. If the large global funds embrace responsible stewardship this could act as a normative force across many share markets. Certainly many of the big players appear to be at the forefront of developments:

28 [Citation]
29 Hong Kong SFC, “Principles of Responsible Ownership,” March 2016, 1.
investors such as Blackrock and Vanguard were amongst the founding members of the industry-led stewardship framework in the United States.\textsuperscript{30}

**Corporate Governance**

It is worth looking in more detail at why corporate governance regulation relies on ownership behaviour on the part of investors. Firstly most corporate governance codes use the ‘comply-or-explain’ mechanism introduced by the United Kingdom code in 1992. This means that the code mandates disclosure of information rather than actual adoption of governance practices. Companies can choose to comply with a governance recommendation or, as an alternative, they can explain why such a practice is inappropriate for their particular company. Legislative provisions are often based on the same principle, for example laws on executive remuneration require disclosure of amounts paid rather than dictating precise rules about how much can be paid. This type of disclosure-based regulation relies upon investor engagement with the information in order to encourage good governance. In other words, it assumes that investors are taking into account the information disclosed when making investment decisions and that they value good governance. In an efficient market, this means that a company’s share price will reflect the quality of its governance. Thus companies will have a strong incentive to improve and explain clearly their governance practices. As Andrew Keay puts it, the present scheme relies on both the stewardship of shareholders and the efficiency of markets.\textsuperscript{31}

However, both academic research and investigations into the global financial crisis have placed doubt on these assumptions. Keay concludes:

> The research suggests that investors do not monitor sufficiently and do not generally bother to engage in any assessment of what companies have done or not done. This is due partly to the fact that monitoring the veracity of explanations is not easily done and if it is done it is costly, and this is typically a reason for the lack of shareholder intervention except at times when there is poor company performance.\textsuperscript{32}

Some stewardship codes also expressly recognise past lack of ownership engagement on the part of investors:

\textsuperscript{30} Hill, “Good Activist/Bad Activist.”

\textsuperscript{31} Andrew Keay, “Comply or Explain in Corporate Governance Codes: In Need of Greater Regulatory Oversight?” *Legal Studies* 34, no. 2 (June 2014): 279, https://doi.org/10.1111/lest.12014.

\textsuperscript{32} Keay, 293.
Recent experience in South Africa and internationally indicates that market failures in relation to governance are, at least in part, due to an absence of active institutional investors, or investment behaviour driven by short-term results.  

Thus corporate governance codes which have spread across the world since the early 1990s rely on market mechanisms which were seen to have failed in preventing the financial crisis. Consequently, one of the reasons for the introduction of stewardship codes is to fix this perceived problem in the functioning of corporate governance codes. The recent Kenyan code explains this well:

For an “apply or explain” system to be effective, an issuer’s explanation of non-application with the Corporate Governance Code needs to be monitored to ensure its explanations are well-reasoned, convincing and provide for acceptable governance arrangements in the event of non-application. This is where institutional investors have a role to play.

The South African code also refers to the role of investors as enforcers of corporate governance codes:

A non-mandatory market-based code of governance, such as the King Code, is (in the context of listed companies) stronger if its implementation is overseen by those with a vested interest in effective market forces i.e. the institutional investor.

It seems that stewardship codes have been introduced to fix perceived problems in disclosure-based regulatory mechanisms. This raises some serious questions, both practical and theoretical. Firstly, simple common sense has to query the idea of fixing a ‘comply-or-explain’ mechanism by adding another ‘comply-or-explain’ mechanism on top. Who is then going to monitor the investors to check that they are following the stewardship code? Secondly, investors are already under various fiduciary duties regarding their investments. Does a policy of using investors to police the governance of listed companies, truly benefit the ultimate beneficiaries of those investments or is it too costly? Lastly, most Anglo American systems of corporate governance have already dealt with the difficulties of shareholder monitoring by arranging for the shareholders to elect a board of

directors to monitor the company on their behalf. What does investor stewardship mean for the role of the board – does it make the board redundant? Each of these questions will be explored below using the evidence available in stewardship codes and policy statements made by their issuers.

**Enforcing stewardship codes**

The Danish code confirms that it is based on voluntariness and the ‘comply or explain’ principle. There is an interesting comment where the Committee states that it:

> ...finds that self-regulation is the best form of regulation when it comes to corporate governance... however it requires that society, companies and investors have a positive attitude towards stewardship and that they engage in stewardship activities.

Here the Danish code recognises the lack of enforcement by anyone other than civil society and code reliance on voluntary action. The UK code provides a few more clues as to code enforcement as it suggests that asset owners ought to read the disclosures of asset managers and vice versa and that this should improve the functioning of the market for investment mandates as well as enabling asset owners to better fulfil their duty to their beneficiaries.\(^{37}\) Ultimately the UK code seems to be looking to ‘clients and beneficiaries’ as the audience for investor disclosures around stewardship. Thus the idea is that asset owners (e.g. pension funds) will read the disclosures of the asset managers whom they employ, while civil society (e.g. pension beneficiaries) will be overseeing the disclosures of their pension funds. Whether this is true in practice is unclear and worthy of future research. It seems we may be trying to push responsibility for corporate governance back up the investment chain when (as discussed below) the structure imposed by law is for shareholders to delegate this responsibility to a board of directors.

The Brazilian code refers to the possibility of enforcement by AMEC, the code issuer. Here lies an alternative regulatory approach, sometimes known as enforced self-regulation, whereby soft law gains a small amount of legal or other supervisory backing.\(^{38}\) The United Kingdom regulator has travelled some way down this path through its monitoring of signatory statements. Each year the Financial Reporting Council (FRC) assesses a sample of signatory statements against the code’s

principles. In 2016 the FRC also undertook a tiering exercise to distinguish between signatories that report well and those where improvements were necessary.\(^{39}\)

**Stewardship and fiduciary duties of investors**

The Danish code states that its aim is ‘to promote companies’ long term value creation and thereby contribute to maximising long-term returns for investors’. Similarly the UK code ‘aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper’.\(^{40}\) In the Netherlands the code claims that responsible use of share rights is ‘key to creating long term value for the company and all its stakeholders, including shareholders’. Japan’s code refers to the responsibilities of institutional investors to ‘enhance the medium-to long-term investment return for their clients and beneficiaries (including ultimate beneficiaries...) by improving and fostering the investee companies’ corporate value and sustainable growth through constructive engagement’.\(^{41}\) Thus there is a common assumption behind these codes that stewardship activity improves long-term investment returns.

However the Danish code also makes clear that the scope and exercise of stewardship activities should be considered in light of portfolio allocation, investment strategy; investment method, number of shares owned in a particular company and an assessment of the need to seek influence on company operations. The code clarifies that its aim is transparency rather than establishment of a uniform approach. The UK code also provides for variation by stating that application of the code ‘should be aligned with the signatory’s role in the investment chain’.\(^{42}\) Likewise, the Swiss code confirms that participation rights in listed companies should be exercised by institutional investors only insofar as this is deemed appropriate and feasible in the interests of their clients. Indeed, the Swiss code is one of the few codes that refers to the costs of active ownership – it is only deemed appropriate to exercise participation rights ‘if the associated expenditure is justifiable and reasonable from the point of view of adequately safeguarding the interests of their clients’.

This is a vital point because it is likely these costs were one of the factors that discouraged investors from active ownership prior to the advent of stewardship codes. If the costs were too high in the past, why would anything be different now? Academics have long pointed to the cost of monitoring a huge number of investments as a barrier to effective stewardship.\(^{43}\) The UK code and the Italian

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40 FRC, “The UK Stewardship Code.”
code recognise that active ownership may be more costly than simply selling a low-performing holding. Both codes confirm that compliance with the code does not preclude a decision to sell a holding, where this is in the best interest of clients or beneficiaries. On the other hand the Myners report in the United Kingdom pointed out that large holdings cannot always be sold easily and there will be times when intervention is the right action for a fund manager to take. Indeed, it needs to be remembered that stewardship codes were introduced against a background of concern over sub-optimal decision making on the part of institutional investors and potential failures to meet their fiduciary duties. It seems there is a balance that investors are expected to meet somewhere between lazy investing (no research into company performance) and overly active investing (excessive and costly research and engagement).

Over a decade ago when the idea of responsible or ethical investing first took hold, the question of its compatibility with investors’ fiduciary duties was questioned. In most countries large institutional investors, particularly pension funds, are under a legal duty to act in the interests of their beneficiaries rather than serving their own interests. There has been much debate over the extent to which this amounts to a duty to maximise investment returns. In what circumstances is it permissible for an investor to, for example, screen out high-performing but unethical or non-environment friendly investments? The legal situation was thoroughly investigated in a report commissioned by UNEP and carried out by the law firm Freshfields Bruckhaus Deringer.

In what was seen as a radical decision at the time, the report concluded that, ‘integrating ESG considerations into an investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions’. Thus, as long as long-term financial performance is the ultimate measure, investors can, and should, take into account ESG factors. However, if priority is to be given to ESG factors over financial performance, this may require clients to actively choose and consent to such a strategy. In 2015, a follow-up report to the initial Freshfields study confirmed that the concept of responsible investment had become widely

45 Myners, 5.
48 Freshfields Bruckhaus Deringer, “A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment.”
accepted but that its implementation was not fully developed.\textsuperscript{49} For many ESG factors (climate change being a growing exception) there is still a lack of risk measurement tools and standardised reporting. This makes it difficult for investors to draw reliable conclusions about their financial implications.\textsuperscript{50}

Nevertheless, the South African code describes incorporation of ESG activities as being part of the delivery of ‘superior risk-adjusted returns to the ultimate beneficiaries’. It refers to the fact that this is now accepted in South African regulation:

\begin{quote}
Regulation 28 issued by the Minister of Finance under section 36 of the Pension Funds Act 1956 now also states in its preamble that prudent investing “should give appropriate consideration to any factor which may materially affect the sustainable long-term performance of a fund’s assets, including factors of an environmental, social and governance character”.\textsuperscript{51}
\end{quote}

Overall a proportional level of investor monitoring and engagement is likely to be in the best interests of beneficiaries. For institutional funds to go further they generally need the consent of their clients or, if law reform moves towards responsible investing, they may become subject to other external obligations to take account social and environmental issues, that are independent of their fiduciary duties.\textsuperscript{52}

\textbf{Stewardship and the role of the board}

Only a few codes mention the impact of investor stewardship on the role of the board. The UK stewardship code describes stewardship of publicly listed companies as shared:

\begin{quote}
The primary responsibility rests with the board of the company, which oversees the actions of its management. Investors in the company also play an important role in holding the board to account for the fulfilment of its responsibilities.\textsuperscript{53}
\end{quote}

The Japanese code refers to the function of the board and that of institutional investors as being complementary to each other. However it confirms that decisions on key policy and business matters are the board’s responsibility. Several other codes ask investors to restrain from micro-managing the affairs of investee companies implying that this remains in the hands of company

\textsuperscript{49} PRI, “Fiduciary Duty in the 21st Century” (PRI, 2015).
\textsuperscript{50} PRI, 14.
\textsuperscript{52} Sandberg, “(Re-)Interpreting Fiduciary Duty to Justify Socially Responsible Investment for Pension Funds?“
\textsuperscript{53} FRC, “The UK Stewardship Code,” 1.
directors and managers.54 The Singapore code encourages investors to ‘satisfy themselves that the
investee company’s board and board committee structures are effective, and that independent
directors provide adequate oversight’.55 The Canadian code confirms that the main purpose of
engagement on governance matters is to ‘improve the effectiveness of the board, its committees
and its directors in minimizing risk and maximizing the long-term of the company’.56

Thus the double agency dilemma described by corporate governance scholars appears in practice as
two layers of monitoring: boards monitor managers and shareholders monitor boards.57 As
discussed above there can be said to be a third layer of agency whereby beneficiaries (comprising a
large portion of civil society) monitor their fund managers.58 Paradoxically, this means that the
concept of shareholders as stewards is based on agency theory rather than stewardship theory. The
idea is that if shareholders are more involved in monitoring the companies they invest in, this will
reduce the likelihood of managerial misbehaviour. Alternatively it may reflect acceptance of
stewardship theory but only at the level of institutional investors. If managers are too self-
interested to act as stewards; and boards also can’t be fully trusted; soft law has now turned to the
large pension funds to act as stewards of the economy. The Brazilian code sets the scene:

> What players would have more propriety, power and duty of taking care of sustainable
returns adjusted to the risks? The institutional investors – whether fund managers or
pension funds. They are the ones with the largest participation in the different market
segments (shares, debentures, derivatives, receivables investment funds, etc.). Accordingly,
due to their size and relevance, institutional investors should play a central role in defending
the sustainability of the financial market.

To some extent this reflects the idea of universal ownership, a perspective that argues that some of
these huge investors hold such large and diverse portfolios that their holdings represent a cross-
section of an entire economy. They cannot escape market impacts by simply selling a few shares
and thus they should have a natural interest in ‘universal monitoring’.59 However, it is perhaps

54 European Fund and Asset Management Association, “EFAMA Code for External Governance: Principles for
the Exercise of Ownership Rights in Investee Companies,” April 2011, 3.
56 Canada Coalition or Good Governance, “Principles for Governance Monitoring, Voting and Shareholder
58 Jonathan D. Raelin and Krista Bondy, “Putting the Good Back in Good Corporate Governance: The Presence
59 Juravle and Lewis, “Identifying Impediments to SRI in Europe”; James P. Hawley and Andrew T. Williams,
“The Universal Owner’s Role in Sustainable Economic Development,” Corporate Environmental Strategy 9, no.
3 (2002): 284–291; Matthew J. Kiernan, “Universal Owners and ESG: Leaving Money on the Table?,” Corporate
worrying to place quite such a level of responsibility on these organisations when they have already been criticised for lack of accountability to their own beneficiaries.\footnote{Juravle and Lewis, “Identifying Impediments to SRI in Europe.”}

**Effectiveness of stewardship codes**

We should now return to the broad purpose of stewardship codes – to improve long-term corporate value through active ownership by large shareholders. Are they likely to achieve this aim? A full answer to this question requires a lot more research as well as the passage of time. However, the discussion in this article helps to identify at least four stages where the process could falter. Firstly, the self-governance model inherent in comply-or-explain with its lack of enforcement could be a problem.\footnote{Cheffins, “The Stewardship Code’s Achilles’ Heel.”} On the other hand, voluntary action coupled with a level of regulatory supervision in many countries may be enough to encourage investors to make the relevant disclosures. Secondly we need to ask whether compliance with these stewardships codes will actually change investor behaviour. Will they simply make a statement about their engagement policy or will they actually take action? Thirdly, will the increased monitoring and engagement by investors translate to changes in the strategies of listed corporations? Lastly, will those changes be oriented towards long-term sustainability?

Cheffins maintains that the UK Stewardship Code’s Achilles heel arises from the fact that share ownership trends place key investors outside the Code’s mandate. This is due to the fragmentation of share ownership in publicly traded companies and the fact that, in the United Kingdom at least, the stewardship code only targets a small proportion of shareholders – the domestic institutions. He points out that even if these domestic institutional investors are active it is open to question whether their holdings are large enough to get companies to listen.\footnote{Cheffins, 1020.}

Of course, this is why most stewardship codes encourage collective or collaborative engagement. Perhaps if investors band together they can both increase their voice as well as reduce costs. In several countries, collective behaviour has been encouraged by removing any perceived barriers, for example, by clarifying that laws on shareholders ‘acting in concert’ and/or mandatory takeover rules, do not apply.\footnote{European Securities and Markets Authority, “Information on Shareholder Cooperation and Acting in Concert under the Takeover Bids Directive,” June 20, 2014.} Care has also been taken to clarify that investor engagement should not


\footnote{Cheffins maintains that the UK Stewardship Code’s Achilles heel arises from the fact that share ownership trends place key investors outside the Code’s mandate. This is due to the fragmentation of share ownership in publicly traded companies and the fact that, in the United Kingdom at least, the stewardship code only targets a small proportion of shareholders – the domestic institutions. He points out that even if these domestic institutional investors are active it is open to question whether their holdings are large enough to get companies to listen. Cheffins, 1020. Of course, this is why most stewardship codes encourage collective or collaborative engagement. Perhaps if investors band together they can both increase their voice as well as reduce costs. In several countries, collective behaviour has been encouraged by removing any perceived barriers, for example, by clarifying that laws on shareholders ‘acting in concert’ and/or mandatory takeover rules, do not apply. Care has also been taken to clarify that investor engagement should not.
involve the release of insider information.\textsuperscript{64} Other initiatives include the setting up of organisations such as the Investor Forum in the United Kingdom that facilitate collective action on particular topics.

Certainly the influence of large investors on listed companies is an assumption behind stewardship codes that ought to be empirically tested. The Malaysian code clearly outlines the assumption:

Institutional investors are major players in the global economy who can exert significant influence over their investee companies due to the substantial stake they hold. This clout provides them with an opportunity and ability to encourage good governance and appropriate behaviour by their investee companies to ensure delivery of sustainable long-term value for their beneficiaries or clients.\textsuperscript{65}

Another potential barrier to effectiveness that has been recognised in most codes is the fact that most institutional investors (the asset owners) contract out the management of their assets to asset managers. Most codes insist that asset owners clearly communicate their stewardship policies to asset managers and ensure that they follow these policies.\textsuperscript{66} Many of them also encourage the asset managers to become signatories to the code themselves. However, Juravle and Lewis review impediments to responsible investing at institutional, organisational and individual levels. An important factor that they identify is the way that fund managers are employed and remunerated, an element of the internal governance of fund management firms.\textsuperscript{67} The only national code, to date that deals with these internal governance issues is the Australian code, perhaps because it has asset managers (rather than asset owners) as its main focus. The ICGN code also includes provisions on internal governance including a statement that:

Investors should reinforce their obligations to act fully in the interests of beneficiaries or clients by setting fee and remuneration structures that provide appropriate alignment over relevant time horizons.\textsuperscript{68}

A final element of the success of stewardship codes will be whether the investor influence is directed at long term sustainability rather than short term performance. Here Jennifer Hill identifies the two different types of investor activism.\textsuperscript{69} In the United States ‘bad’ activists have traditionally been concerned with short term profits whereas in Europe there has been more ‘good’ activism

\begin{itemize}
\item\textsuperscript{64} See for example, Hong Kong SFC, “Principles of Responsible Ownership,” 4.
\item\textsuperscript{65} Minority Shareolder Watchdog Group, “Malaysian Code for Institutional Investors,” June 2014, 3.
\item\textsuperscript{66} For example, Minority Shareolder Watchdog Group, 4.
\item\textsuperscript{67} Juravle and Lewis, “Identifying Impediments to SRI in Europe.”
\item\textsuperscript{68} ICGN, “ICGN Global Stewardship Principles,” 2016, 13.
\item\textsuperscript{69} Hill, “Good Activist/Bad Activist.”
\end{itemize}
around environmental and social issues. As Cheffins states, the assumption that shareholder activism is always a ‘good thing’ cannot be taken for granted.\textsuperscript{70}

As this article was written, comments by the new chairman of BHP Billiton, one of the largest mining companies in the world, were featured in the news.\textsuperscript{71} He had just returned from a ‘listening tour’ of more than 100 investors in eight countries and commented, at the company’s AGM, that ‘it is the role of the board as the company’s stewards to listen and be responsive to our stakeholders’. He added, ‘ultimately it is up to the board to choose the course it believes will best benefit shareholders’. This was against a background of the company being pursued by a New York based activist investor, a hedge fund focused on shareholder returns. Elliot Management had raised its stake in the company to five per cent and was campaigning for BHP to divest its petroleum business and increase shareholder returns. Thus we see the competing narratives around shareholder engagement playing out in practice, the ‘good activist’, ‘bad activist’ conundrum recognised by Jennifer Hill.\textsuperscript{72} The need to engage with shareholders certainly places increased pressure on boards of directors and reveals more clearly their important role in mediating the competing interests of different shareholders and wider stakeholders.\textsuperscript{73}

Most stewardship codes only encourage the incorporation of ESG concerns to the extent they impact on long-term financial performance. For example, the Hong Kong code refers to engagement on ‘significant ESG issues that have the potential to impact on the companies’ goodwill, reputation and performance’. The South African code probably takes the strongest stance on sustainability stating in its first principle that investors ‘should incorporate sustainability considerations, including ESG, into its investment analysis and investment activities’.

The PRI has conducted some early research into whether stewardship codes make a difference to long-term investing. The research showed that companies in countries with mandatory, government-led, comprehensive ESG reporting requirements have, on average, a 33 per cent better MSCI ESG rating than those in countries without.\textsuperscript{74} Thus improvements in responsible investing cannot be attributed to stewardships codes alone. There have been many other legal and non-legal initiatives to support long term responsible investment. These include the Taskforce on Climate-related Financial Disclosures, the UN sustainable development goals and the Interim Report of the High-level Expert Group on Sustainable Finance in Europe. What we are witnessing is a slow process

\textsuperscript{70} Cheffins, “The Stewardship Code’s Achilles’ Heel,” 1025.
\textsuperscript{72} Hill, “Good Activist/Bad Activist.”
\textsuperscript{73} Margaret M. Blair and Lynn A. Stout, “Director Accountability and the Mediating Role of the Corporate Board,” \textit{Wash. ULQ 79} (2001): 403.
\textsuperscript{74} Reynolds, “Stewardship Codes Guide Best Practice.”
of institutionalisation of responsible investing and stewardship. This process of institutionalisation gives rise to a group of structures, rules and standards which although set up in a rather unplanned and non-centralised way can modify the way companies function.\footnote{Thomas Lamarche and Marianne Rubinstein, “Dynamics of Corporate Social Responsibility: Towards a New ‘Conception of Control’?,” \textit{Journal of Institutional Economics} 8, no. 02 (June 2012): 168, https://doi.org/10.1017/S174413741100049X.}

Conclusions

As the South African stewardship states ‘we are facing socio-economic challenges and climate change which threatens our own existence as human society. This is a trend that cannot be allowed to continue’.\footnote{Institute of Directors Southern Africa, “CRISA Code for Responsible Investing in South Africa,” 4.} Nobody can dispute the United Nations sustainable development goals: of course we should aim for zero poverty, reduced inequality, clean energy, protection of the environment and so on. Also indisputable is the fact that progress towards these goals requires both the public and private sector to be involved. The corporate responsibility movement often points out that corporations have more power and wealth than many small nation states. Whether we like it or not corporate behaviour will shape our overall progress towards these goals. This means that resolving the conflict between long-term sustainability and short term financial gain is becoming more and more important. If we are to achieve sustainable development there is a pressing need for companies to feel confident in prioritising long-term goals over short term gains. This is difficult in a market that monitors share price by the minute, thus any initiative that has the potential to tip the balance towards longer-term investing is worth exploring. Stewardship codes can be seen as a small but significant part of the overall move towards long-term sustainability.
**Table 1 Stewardship codes or similar initiatives worldwide**

<table>
<thead>
<tr>
<th>Country</th>
<th>Title</th>
<th>Date</th>
<th>Mechanism</th>
<th>Code issuer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Australia</td>
<td>Principles of Internal Governance and Asset Stewardship</td>
<td>July 2017</td>
<td>Mandatory for members of FSC</td>
<td>Financial Services Council (FSC)</td>
</tr>
<tr>
<td>4. Denmark</td>
<td>Stewardship Code</td>
<td>Nov 2016</td>
<td>Comply or explain</td>
<td>The Committee on Corporate Governance</td>
</tr>
<tr>
<td>5. EU</td>
<td>EFAMA Code for external governance Principles for the exercise of ownership rights in investee companies</td>
<td>April 2011</td>
<td>Voluntary</td>
<td>EFAMA – European Fund and Asset Management Association</td>
</tr>
<tr>
<td>6. Hong Kong</td>
<td>Principles of Responsible Ownership</td>
<td>Mar 2016</td>
<td>Voluntary</td>
<td>Securities and Futures Commission</td>
</tr>
<tr>
<td>7. India</td>
<td>IRDAI decision to implement a stewardship code for insurers</td>
<td>Mar 2017</td>
<td></td>
<td>Insurance Regulatory and Development Authority of India</td>
</tr>
<tr>
<td>8. Italy</td>
<td>Italian Stewardship Principles for the exercise of administrative and voting rights in listed companies</td>
<td>2015 (revised Sept 2016)</td>
<td>Comply or explain</td>
<td>Assogestioni (investor association)</td>
</tr>
<tr>
<td>10. Kenya</td>
<td>Stewardship Code for Institutional Investors</td>
<td>2015</td>
<td>Apply or explain</td>
<td>Capital Markets Authority</td>
</tr>
<tr>
<td>12. Netherlands</td>
<td>Best practices for Engaged Share Ownership</td>
<td>June 2011</td>
<td>Apply-or-explain</td>
<td>Eumedion (investor association)</td>
</tr>
<tr>
<td>13. Singapore</td>
<td>Singapore Stewardship Principles for Responsible Investors</td>
<td>Nov 2016</td>
<td>Voluntary</td>
<td>Stewardship Asia</td>
</tr>
<tr>
<td>15. South Korea</td>
<td>KCGS Stewardship Code</td>
<td>Dec 2016</td>
<td>Voluntary</td>
<td>Korean Corporate Governance Service (KCGS)</td>
</tr>
<tr>
<td>16. Switzerland</td>
<td>Guidelines for institutional investors governing the exercising of participation rights in public limited companies</td>
<td>Jan 2013</td>
<td>Comply or explain</td>
<td>[Collaboration of industry associations]</td>
</tr>
<tr>
<td></td>
<td>Country</td>
<td>Title</td>
<td>Date</td>
<td>Requirement</td>
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<tr>
<td>17</td>
<td>Taiwan</td>
<td>Stewardship Principles for Institutional Investors</td>
<td>June 2016</td>
<td>Comply or explain</td>
</tr>
<tr>
<td>18</td>
<td>Thailand</td>
<td>SEC Investment Governance Code for Institutional Investors</td>
<td>Feb 2017</td>
<td>Comply or explain</td>
</tr>
<tr>
<td>19</td>
<td>United Kingdom</td>
<td>The UK Stewardship Code</td>
<td>2010 (revised 2012)</td>
<td>Comply or explain</td>
</tr>
<tr>
<td>20</td>
<td>United States</td>
<td>ISG Stewardship Framework for Institutional Investors</td>
<td>Jan 2017</td>
<td>Voluntary</td>
</tr>
</tbody>
</table>