Regulating Institutional Shareholders' Engagement Practices for the Promotion of Corporate Sustainability in the UK - Demanding from Old Dogs New Tricks?

By

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Parallel to the EU's regulatory developments in the area, British policymakers appreciate that institutional shareholders' engagement practices espousing shareholder stewardship's ideal for them as perceived in the UK can be a powerful lever for influencing investee companies to adopt decision-making propitious to enabling corporate sustainability. The regulations introduced to transpose the Second Shareholder Rights Directive and follow the Law Commission's recommendations alongside the 2020 Stewardship Code are aspired to ensure that such engagement practices will uphold corporate sustainability, whereas regulation aiming to advance sustainable finance is projected to supply necessary information. This Article examines the normative imperative about institutional shareholders' engagement practices deriving from the main regime governing them following the introduction of the former instruments as it will interact with the latter and argues that it may not credibly impress on them that their engagement practices should promulgate corporate sustainability. The regime arguably allows such engagement practices to transpire as being consistent with institutional shareholders' duties and other responsibilities to clients and beneficiaries. Yet institutional shareholders still retain significant discretion in shaping engagement practices' objectives, and questioning deviations from a pro-corporate-sustainability standard is elusive. Normative expectations are sought to be imposed through the regulations' application and the 2020 Stewardship Code, with the most notable being the adherence to shareholder stewardship's ideals. These expectations offer a proxy for promoting corporate sustainability through engagement whenever it is overall advantageous to shareholder-value creation. Albeit intuitive, the scope given to endorse corporate sustainability by them can prove at odds with its facilitation.

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1. Introduction

Recent policy and regulatory developments pertaining to sustainable development[1] across the world have proliferated the pleas for succouring "corporate sustainability", namely the embedment of sustainable development's goals in corporate governance, and their analogous pursuit via the addressment of environmental, social and economic matters likely to impact companies or produced by them at a rate of affecting others adversely ("ESG considerations").[2] In the UK, policymakers regard engagement by institutional shareholders (asset owners, namely pension funds and insurers, and asset managers)[3] that adheres to shareholder stewardship's ideal for it and its commensurate monitoring (usually taking place when investment management is delegated to an asset manager) as being principal drivers for it.[4] Recent reforms purport to facilitate the processes required to realise engagement practices' functioning to this end. Key regulations enacted in transposition of the Second Shareholder Rights Directive ("SRDII") and in response to the Law Commission's recommendations alongside the 2020 Stewardship Code (collectively, "regulation for shareholder stewardship") are aspired to ingrain shareholder stewardship's ideal for shareholder engagement and its monitoring in institutional shareholders to the point where their practices will be versed by ESG considerations and be systemised towards promoting sustainable

[1] Sustainable development is usually taken to mean 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs' as per the definition given in UN World Commission on Environment and Development, "Report of the World Commission on Environment and Development: Our Common Future" (WCED, 1987), Ch. 2. However, several definitions for it and their interchangeable use with the term "sustainability" have since been surfaced, creating complications over what sustainable development represents. See on this issue, *Paul Johnston et al.*, "Reclaiming the Definition of Sustainability", Environmental Science and Pollution Research International 14 (2007), 60; and *Tom M. Parris/Robert W. Kates*, "Characterizing and Measuring Sustainable Development", Annual Review of Environmental Resources, 28 (2003), 559.

[2] The definition given to corporate sustainability herein derives from similar ones found in the corporate law literature. See, for example, *Beate Sjåfjell/Christopher M. Bruner*, Corporations and Sustainability, in: Beate Sjåfjell/Christopher M. Bruner (ed.), The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, 2019, p. 11; and *Wolf-Georg Ringe*, "Investor-led Sustainability in Corporate Governance", Annals of Corporate Governance 7 (2022), 93, 98. However, this definition is far from being the accepted one. See on this, *Georgina Tsagas/Charlotte Villiers*, "Why 'Less is More' in Non-Financial Reporting Initiatives: Concrete Steps Towards Supporting Sustainability", The Journal of Accounting, Economics and Law: A Convivium 10 (2020), 1, 6-9; and, from a management studies perspective, *Thomas Dyllick/Katrin Muff*, "Clarifying the Meaning of Sustainable Business", Organisation & Environment 29 (2016), 156.

[3] The term "insurers" is used to denote undertakings carrying out activities of life assurance and reinsurance. The term "pension funds" is used to denote institutions providing occupation retirement schemes established either on a contractual or trust basis. The term "asset manager" is used herein to refer to a firm providing portfolio management services regulated by the Financial Conduct Authority ("FCA"), an Alternative Investment Fund Manager, a UCITS management company or an investment company with variable capital that is a UCITS scheme without a separate a management company.

[4] HM Government, "Greening Finance: A Roadmap to Sustainable Investing" (October 2021), p. 31-32 ("Roadmap to Sustainable Investing"); HM Government, 'Mobilising Green Investment: 2023 Green Finance Strategy' (March 2023), p. 53, 55-60 ("2023 Green Finance Strategy").

business.[5] Furthermore, current and future regulation directed at bolstering sustainable development's financing ("regulation for sustainable finance") is aimed, inter alia, to provide institutional shareholders with the information required to engage with investee companies or monitor it once delegated for these issues.[6]

Identifying whether institutional shareholders' routing to approach their engagement practices accordingly will be successful in regard to upholding corporate sustainability propounds ruminating over institutional shareholders' incentive to do so, and its potential engenderment by the enforcement of the regulation for sustainable finance and the regulation for shareholder stewardship. Both factors have attracted the attention of scholars, tarrying them in confliction over their particulars.[7] This Article does not intend to ply with the debates around these. Instead, it examines the normative imperative about institutional shareholders' engagement practices deriving from the main legal regime regulating them following the introduction of the regulation for shareholder stewardship as its application interacts and will interact with the current and future regulation for sustainable finance; for there is reason to believe that it may not credibly impress on them that their engagement practices should mainstream corporate sustainability. For the sake of clarity, the term "shareholder stewardship" is used herein to describe the regulatory concept introduced in the UK shortly after the 2008 financial crisis as it has evolved to elongate beyond the propagation of frequent and responsible shareholder engagement.[8] Shareholder stewardship is understood to be capturing the venture of ensuring that institutional shareholders' management, allocation and oversight of capital will warrant the long-term financial prosperity of their clients and beneficiaries out of seconding investee companies' strategies guaranteeing their success and longevity, deducing in parallel socially favourable outcomes.[9]

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[5] *Ibid*; Directive 2017/828 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, Art 3g, 3h and 3i ("SRDII") - These have been transposed by the FCA and the Department of Work and Pensions ("DWP") respectively. See Shareholder Rights Directive (Asset Managers and Insurers) Instrument 2019 FCA 2019/68; Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019, SI 2019/982; the Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018, SI 2018/988; Conduct of Business Sourcebook (Independent Governance Committees) Instrument 2019 FCA 2019/102; Financial Reporting Council ("FRC"), "The UK Stewardship Code 2020" (2020) ("2020 Stewardship Code").

[6] *ibid.*

[7] For an overview of the discussions and debates made around them, see *Iris H-Y Chiu*, The Evolution of 'Engagement' as a Norm in Investment Stewardship in the UK and the Impact of Sustainability Demands, in: Iris H-Y Chiu/Hans Christoph Hirt (ed.), Investment Management, Stewardship and Sustainability: Transformation and Challenges in Law and Regulation, 2023; *Iris H-Y Chiu*, "Governing the Purpose of Investment Management: How the 'Stewardship' Norm is being (Re)Developed in the UK and EU", European Corporate Governance Institute - Law Working Paper No. 602/2021, 2021, https://ssrn.com/abstract=3908561 accessed 16 March, 2023.

[8] For the purpose of this Article, shareholder engagement denotes the exercise of shareholders' voting rights, the institution of dialogue with investee companies and other interested groups, either in private or in public, and the monitoring of the financial and non-financial performance of companies. For an overview of shareholder engagement, see *Paul Davies*, Shareholders in the United Kingdom, in: Jennifer G. Hill/Randall S Thomas (ed.), Research Handbook on Shareholder Power, 2015.

[9] Shareholder stewardship's conception is attributed to the Walker Review, see HM Treasury, "A review of Corporate Governance in UK Banks and other Financial Industry Entities: Final recommendations" (November 2009) ("Walker Review"). Since then, shareholder stewardship has substantially evolved on a global level. See on this, *Dionysia Katelouzou/Dan Puchniak*, Global Shareholder Stewardship: Complexities, Challenges, and Possibilities, in: Dionysia Katelouzou/Dan Puchniak (ed.), Global Shareholder Stewardship, 2022.

The Article finds the regime underscoring the engagement practices' undertaking as part of an investment strategy executed per institutional shareholders' key duties owed to their clients and beneficiaries and other responsibilities, denoted by the furtherance of the purpose of the investing activity for their best interests. While engagement practices permeated by ESG considerations and supportive of corporate sustainability appear to be permissible subject to the aforementioned qualifications, the duties and responsibilities still afford significant discretion to institutional shareholders apropos of shaping their object, and questioning deviations from promoting corporate sustainability through engagement practices can prove difficult to take place.[10] The application of the regulation for shareholder stewardship is sought to place several normative expectations about shareholder engagement and its monitoring, from at least considering their adoption to utilising them per the shareholder stewardship's ideal for them; whereas the regulation for sustainable finance is meant to aid in supplementing the information needed to consider issues pertinent to corporate sustainability in investee companies. The extent to which these expectations can be prudent paeans for engagement practices supportive of corporate sustainability, however, is open to question. The expectations echo the confidence policymakers and regulators put in taking action signalled by the quest for creating shareholder value and estimates made around it by factoring issues likely affecting it in the long-term to uphold obliquely investee companies' longevity and aggregate social welfare.[11] Contemplating engagement practices to be undertaken in the vigour of the latter offers a proxy for endorsing corporate sustainability mainly when it can be reflected in, or being reflective of, the creation of shareholder value following the assessment of all factors capable of affecting it. Assenting to corporate sustainability whenever a 'business case' advantageous to shareholder-value creation is apparent is intuitively appealing, but it can prove at odds as a normative injunction with corporate sustainability's multidimensional and multifaceted prognostications.

To elaborate on the argument in depth, the Article proceeds as follows. Section 2 briefly recounts the trajectory which led to the current state of the regulation for shareholder stewardship and the policy objectives animating it. Following its elucidation in Section 3, Section 4 analyses the normative imperative about institutional shareholders' engagement practices the regime in question poses. Section 5 concludes.

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[10] Similar findings were found in *Andrew Johnston/ Rachelle Belinga/ Blanche Segrestin*, "Governing Institutional Investor Engagement: from Activism to Stewardship to Custodianship?" Journal of Corporate Law Studies 22 (2021), 45, 52-56.

[11] See, from an SRDII perspective, *Hanne S. Birkmose*, "From Shareholder Rights to Shareholder Duties – A Transformation of EU Corporate Governance in a Sustainable Direction?" Journal for the International and European Law, Economics and Market Integrations 5 (2018), 69. Note must be made that the regulation for shareholder stewardship was introduced in response to tackling "short-termism", namely the process where frequent trading of shares entails adverse effects for companies in response to pressure exerted on them to maintain or increase share prices and/or profitability. The response is aspired to lead in "long-termism", the process of trading shares endorsing a well-performing corporate economy. Whether short-termism is a problem for corporate governance, and whether long-termism is the antidote to its malaise, remain debateable. See for example, *Robert Anderson*, "The Long and Short of Corporate Governance", Georgetown Mason Law Review 23 (2015), 19; and *Marc T. Moore/Edward Walker-Arnott*, "A Fresh Look at Stock Market Short-termism", Journal of Law and Society 41 (2014), 416. Note must be made though that much of the discussion is usually centred on shareholder value creation, a concept supposed to be "long-termist". See on this, *Michael C. Jensen*, "Value Maximization, Stakeholder Theory, and the Corporate Objective Function", Journal of Applied Corporate Finance 14 (2001), 8.

2. A Prelude to the Regulation for Shareholder Stewardship and Respective Policies

Since its inception, shareholder stewardship is projected to 'normify' frequent and responsible engagement practices by institutional shareholders.[12] The nucleus of the narrative giving life to the endeavour, though, is hardly recent. Bound up in an aggregate/contractarian outlook of companies centred around keeping directors accountable for the creation of shareholder value,[13] engagement practices by institutional shareholders have been traditionally encouraged for their potential to improve corporate performance when motivating prudent corporate governance, creating in turn greater shareholder value and strengthening the economy in aggregate.[14] It has been furthermore stated that such engagement practices can contemporaneously meliorate returns for clients and beneficiaries, bearing thusly the potential to spring additional social benefits.[15] Many iterations of both in policies commending shareholder stewardship's significance refer to institutional shareholders' engagement practices' potential to create 'long-term value', denoting better returns for clients and beneficiaries out of shareholder value creation calibrated by their investment horizons, the long-term holdings of shares, and a focus over supporting and safeguarding investee companies' long-term financial performance.[16]

Despite the exigencies made for their presence, a series of events and empirical evidence confirms so far the weak link between institutional shareholders' theoretical faculty to engage or monitor engagement thusly and their actual approach to them.[17] Institutional shareholders in the UK continue exhibiting apathy for investee companies' governance, accompanied by a tendency to divest shares whenever investee companies' performance is suboptimal.[18] In case engagement

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[12] *Iris H-Y Chiu*, "Turning Institutional Investors into 'Stewards'- Exploring the Meaning and Objectives in "Stewardship"", Current Legal Problems 66 (2013), 443, 445-464. This trend is hardly endemic. See on this, *Katelouzou/Puchniak* (fn. 10).

[13] For an overview of the theories apprised by the outlook, see *Alan Dignam/Michael Galanis*, The Globalisation of Corporate Governance, 2009, Ch.1. For a critical account of them, see *Lorraine E. Talbot*, Progressive Corporate Governance for the 21st Century, 2013.

[14] See, for example, Adrian Cadbury, "Report of the Committee on the Financial Aspects of Corporate Governance" (Gee 1992), paras 6.9–6.11; Hampel Committee, "Committee on Corporate Governance: Final Report" (Gee, 1998), paras 5.10-5.11; Walker Review, p. 69-71, BIS, "The Kay Review of UK Equity Markets and Long-term Decision Making: Final Report" (July 2012), p. 44-47 ("Kay Review").

[15] Paul Myners, "Institutional Investment in the United Kingdom: A Review" (2001), paras 54-57 ("Myners Report"); Kay Review, Ch.6; Walker Review, p. 69-71.

[16] See for example, FRC, "Developments in Corporate Governance 2012: The impact and implementation of the UK Corporate Governance and Stewardship Codes" (December 2012); FRC/FCA, "Building a Regulatory Framework for Effective Stewardship" (Discussion Paper DP19/1, January 2019), p. 11-12 ("Discussion Paper DP19/1"); and FRC/FCA, "Building a Regulatory Framework for Effective Stewardship: Feedback to DP19/1" (Feedback Statement FS19/7, October 2019), p. 11-16 ("Feedback Statement FS19/7"). Although references to shareholder stewardship as perceived in the UK are not evident, a similar conception to this narrative is evident at an EU level as well post-2008 financial crisis, again See *infra* (fn. 39).

[17] The issue is hardly recent. See *Jennifer G. Hill*, "Visions and Revisions of Shareholders in Corporate Governance", The American Journal of Comparative Law 48 (2000), 39; and *Jennifer G. Hill*, "Good Activist/Bad Activist: The Rise of International Stewardship Codes", Seattle Law Review 41 (2018), 497.

[18] For empirical findings, see, for example, *Anna Tilba/Terry McNulty*, "Engaged Versus Disengaged Ownership: The Case of Pension Funds in the UK", Corporate Governance: An International Review 21 (2013), 165. The collapse of Carillion Plc was one such event signifying institutional investors' treatment of shareholder engagement, but also the

practices are evident, they are usually perceived to be 'box-ticking', symbolistic, or prone to putting pressure for generating institutional shareholders greater financial gains for the time the shares are held – usually alluded to 'short-termist' tactics of investing – in recklessness to the threat corresponding corporate decision-making can pose to their longevity or social welfare generally.[19]

Several reasons explicating institutional shareholders' attitude towards shareholder engagement and its monitoring have been cited, ranging from institutional shareholders' insetting to capital markets systemically foregrounded on short-term financial gain,[20] to the proliferation of investment intermediation,[21] institutional shareholders' business models,[22] conflicts of interest,[23] the lack of reliable information,[24] and collective action problems.[25] Law has been noted to have had perennially limited effect in alleviating their severity as well. Besides shareholder power's increase, company law in the UK is not much pre-occupied with the regulation of its use or any activities surrounding it, save for some qualifications applicable in specific instances.[26] Founded

role of the board of directors of the company in 'forcing their hand' despite their efforts to challenge their decision-making. See House of Commons/Business, Energy and Industrial Strategy ("BEIS")/Work and Pensions Committees, "Carillion: Second Joint Report from the Business, Energy and Industrial Strategy and Work and Pensions Committees of Session 2017–19, Tenth Report of the Business, Energy and Industrial Strategy Committee of Session 2017–19 Twelfth Report of the Work and Pensions Committee of Session 2017–19 Report" (May 2018), p. 48-51.

[19] House of Commons Treasury Committee, "Banking Crisis: Reforming Corporate Governance and Pay in the City: Ninth Report of Session 2008-09" (May 2009), p. 64; Kay Review, Ch. 1-5.

[20] *David Millon*, "Shareholder Social Responsibility" Seattle University Law Review 36 (2013), 911; *Emeka Duruigbo*, "Stimulating Long-term Shareholding", Cardozo Law Review 33 (2012) 1734. Cf *Mark J. Roe*, "Corporate Short-Termism – In the Boardroom and in the Courtroom", Business Lawyer 68 (2013) 977; *Jesse M. Fried*, "The Uneasy Case for Favoring Long-Term Shareholders", Yale Law Journal 124 (2015), 1554. Note, however, *supra* (fn. 11). Note must also be made that the debate about short-termism is not new. See *Margaret M. Blair*, Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century, 1995.

[21] *Usha Rodrigues*, "Corporate Governance in an Age of Separation of Ownership from Ownership", Minnesota Law Review 95 (2010-2011), 1822; *John Morley*, "The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation", Yale Law Journal 123 (2013), 1228; *Ronald J. Gilson/Jeffrey N. Gordon*, "The Agency Costs of Agency Capitalism: Activist Investors and the Reevaluation of Governance Rights", Columbia Law Review 113 (2013), 863.

[22] See, by reference to institutional shareholders adopting passive investment strategies, *Jennifer S Taub*, "Able but Not Willing: The Failure of Mutual Fund Advisers to Advocate for Shareholders' Rights", Journal of Corporation Law 34 (2009), 102; *Dorothy S. Lund*, "The Case Against Passive Shareholder Voting", Journal of Corporation Law 43 (2017), 493; *Scott Hirst/Lucian Bebchuk*, "Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy", Columbia Law Review 119 (2019), 2029. Cf *Edward B. Rock/Marcel Kahan*, "Index Funds and Corporate Governance: Let Shareholders be Shareholders", ECGI - Law Working Paper No. 467/2019, 2019, https://ssrn.com/abstract=3295098 accessed March 20 2023.

[23] *Jill E. Fisch/Asaf Hamdani/Steven Davidoff Solomon*, "The New Titans of Wall Street: A Theoretical Framework for Passive Investors" Faculty Scholarship at Penn Law 2019, 1983; *Lucian A. Bebchuk/Alma Cohen/Scott Hirst*, "The Agency Problems of Institutional Investors" Journal of Economic Perspectives 31 (2017), 89.

[24] See, by reference to corporate sustainability, notes in discussion at Section 4.1, below.

[25] *Gaia Balp/Giovanni Strampelli*, "Institutional Investor Collective Engagements: Non-Activist Cooperation vs Activist Wolf Packs", Ohio State Business Law Journal 14 (2020), 135. Cf *Madison Condon*, "Externalities and the Common Owner", Washington Law Review 95 (2020), 1.

[26] Most rules under company law dealing with shareholder power is related to shareholders' ability to exercise their voting rights and procedural rules about the general meeting. See on this, generally, *David Milman*, The Company Share, 2018, Ch. 3-6. Case law has given rise to some qualifications applicable in situations where the alteration of the

upon a web of contract, trust and tort law principles governing in-between relationships, investment management law is characterised by efforts to astutely balance the interests found in the institutional investment community, with public intervention being traditionally 'market-led'.[27] But in a world where the industry's structures arguably negate reaching public policy goals for engagement practices, investment management law has been noted for its inability to shape institutional shareholders' approach to them, if not aggravating further the aforementioned factors.[28] The early versions of the Stewardship Code as formal soft law instruments introduced to warrant engagement practices' undertaking per shareholder stewardship's ideal for them proved inadequate in curbing institutional shareholders' conduct.[29] Save for requiring asset managers' disclosure of their commitment to them, compliance was voluntary and mainly comprised of making comply-or-explain disclosures of the policies and practices signatories advanced in embracement of the principles of the early versions of the Stewardship Code.[30] Signatories possessed substantial discretion on the resoluteness of their compliance, and enforcement was restricted to the Financial Reporting Council's ("FRC") evaluation of disclosures and their subsequent quality tiering.[31] In the absence of any meaningful change in the parameters affecting it, the early versions of the Stewardship Code had, admittedly, miniscule effect, leading to "boilerplate reporting" that did not present "excellence in stewardship" or the "outcomes" deriving from signatories' engagement practices.[32]

Notwithstanding, the attempt to homogenise institutional shareholders' standard of engagement practices to shareholder stewardship's ideal for them remains strong. In addition to the continuous support the concept enjoys and the Stewardship Code's revision in 2020,[33] the process of manifesting shareholder stewardship's advent about engagement practices gained momentum thanks to regulatory amendments made for the creation of a "regulatory baseline" for them that is intended alongside the 2020 Stewardship Code's "higher standards" to encourage the transpiration

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company's articles are concern. For an overview of the rules, see *Re Charterhouse Capital Ltd* [2015] B.C.C. 574 (Court of Appeal), [90]-[96].

[27] *Iris H-Y Chiu/Dionysia Katelouzou*, "Making a Case for Regulating Institutional Shareholders' Corporate Governance Roles", Journal of Business Law, 2018, 67, 77-82.

[28] *ibid.* For arguments suggesting the law has contributed to their exacerbation see *Roger M. Barker/Iris H-Y Chiu*, Corporate Governance and Investment Management : The Promises and Limitations of the New Financial Economy, 2017, p. 95-99.

[29] FRC, "The UK Stewardship Code" (July 2010); FRC, "The UK Stewardship Code" (September 2012).

[30] Conduct of Business Sourcebook, Rule 2.2.3R ("COBS"), introduced by Conduct of Business Sourcebook (Stewardship Code) Instrument 2010, FSA2010/57 (November 2010).

[31] FRC, "Developments in Corporate Governance and Stewardship 2015" (January 2016). The tiering exercise was introduced first as a three-tier exercise and was later amended to become a two-tier exercise. As of 2022, the FRC announced that the tiering exercise will no longer apply for compliance with the principles of the 2020 Stewardship Code.

[32] John Kingman, "Independent Review of the Financial Reporting Council" (December 2018), p. 45-46.

[33] See, for example, *ibid*, at p. 46: "Recommendation 43: The FRC needs to engage at more senior level in a much wider and deeper dialogue with UK investors, including both fund managers and representatives of end-investors"; Kay Review, p. 44 at para 6.2: '… The Review believes that stewardship should be key to the equity investment chain'. Other reports signified and declared support for shareholder stewardship too over the years. See, inter alia, BEIS Select Committee, "Report on Corporate Governance" (March 2017), BEIS, "Insolvency and Corporate Governance: Government Response" (August 2018); BEIS, "Restoring Trust in Audit and Corporate Governance: Government Response to the Consultation on Strengthening the UK's Audit, Corporate Reporting and Corporate Governance Systems" (May 2022); Roadmap to Sustainable Investing; 2023 Green Finance Strategy.

of a "market for effective stewardship" demanding frequent and responsible engagement practices.[34] In part, the amendments took place thanks to the Law Commission's recommendations to introduce relevant shareholder engagement provisions for pension funds.[35] Largely though, the traction to the reform was given by the enactment of the SRDII and of its provisions by the Department of Work and Pensions ("DWP") and the Financial Conduct Authority ("FCA") to befit the work already done in canonising shareholder stewardship.[36]

But in addition to this, it is possible for one to observe the concurrent expansion of the matters regulators and policymakers wish to seeing engagement practices being occupied with under the banner of shareholder stewardship to encapsulate ESG considerations. Both the SRDII's recitals and communications from the EU Commission – often by reference to upholding the UN's Principles for Responsible Investment[37] - stated shareholder engagement should factor ESG considerations germane to investee companies' corporate governance as material to long-term value creation.[38] The FRC, the FCA, the DWP and the Pensions Regulator in respective reports and consultations to amend the law and revise the Stewardship Code commensurate to realising shareholder stewardship's advent, including those concerned with the transposition of SRDII, have also raised the need for engagement practices to be informed by ESG considerations, in addition to raising the essentiality of regulating business in virtue of attaining the UN's Sustainable Development Goals.[39]

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[34] Discussion Paper DP19/1, p. 3; Feedback Statement FS19/7, p. 11-16.

[35] The recommendations were initially made by the Law Commission's 2014 Review of pension funds' fiduciary duties, see, Law Commission, "Fiduciary Duties of Investment Intermediaries" (Law Com No.350, 2014). The recommendations gained further traction by another set of recommendations, see Law Commission, "Pension Funds and Social Investment" (Law Com No.374, 2017). In response, the DWP amended the law regulating trust-based pension funds. See the Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018, SI 2018/988. The law regulating contract-based pension funds was also amended to introduce rules governing independent governance committees, See, Conduct of Business Sourcebook (Independent Governance Committees) Instrument 2019 FCA 2019/102.

[36] SRDII, Art. 3g, 3h and 3i as transposed by Shareholder Rights Directive (Asset Managers and Insurers) Instrument 2019 FCA 2019/68; and Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019, SI 2019/982.

[37] UN Principles for Responsible Investment, https://www.unpri.org/about-us/what-are-the-principles-for-responsible-investment accessed 20 March 2023.

[38] SRDII, [14]; European Commission, "Commission Staff Working Document Impact Assessment Accompanying the Document Proposal for a Directive of the European Parliament and of the Council on Amending Directive 2007/36/EC as Regards the Encouragement of Long-term Shareholder Engagement and Directive 2013/34/EU as Regards Certain Elements of the Corporate Governance Statement and Commission Recommendation on the Quality of Corporate Governance Reporting ('comply or explain')" SWD (2014) 0127; European Commission, Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as Regards the Encouragement of Long-term Shareholder Engagement and Directive 2013/34/EU as Regards Certain Elements of the Corporate Governance Statement COM (2014) 0213 final (Commission Impact Assessment).

[39] Discussion Paper DP19/1, p. 14-15; Feedback Statement FS19/7, p. 9-10; UNGA Res 70/1, "Transforming Our World: The 2030 Agenda for Sustainable Development" (25 September 2015) A/RES/70/1. See also, FCA, "Proposals to promote shareholder engagement: Feedback to CP19/7 and Final Rules" (Policy Statement PS19/13, May 2019), paras 1.15-1.17 ("Policy Statement PS19/13"); FRC, "Feedback Statement – Consulting on a Revised UK Stewardship Code" (October 2019); The Pensions Regulator, "DC investment governance" (October 2021); The Pensions Regulator, 'DB Investment Governance' (September 2019).

The inclusion of ESG considerations in those forecasted to occupy engagement practices now coincides with policymakers' more recent envisagement of engagement practices adhering to shareholder stewardship's ideals becoming a major vehicle for promulgating corporate sustainability and sustainable development generally. Hot on the trails of the EU's regulation in the area and other initiatives taken at an international scale,[40] the UK Government in its "Roadmap to Sustainable Investing" report and its "Green Finance Strategy" urged the institutional investment community's need to conform with shareholder stewardship's ideals and integrate ESG considerations in decision-making to keep investee companies into account for the feasibility of their commitment to net-zero business structures and plans to becoming more sustainable.[41] The Government's plan for introducing the regulation for sustainable finance – comprised of a taxonomy of vibrant understandings on what counts as "green" or "sustainable business", and a disclosure regime implemented alongside regulatory steps hitherto taken by the FCA and the DWP – is intended to back engagement practices for the aforementioned end by feeding them with the information required for taking up the task.[42] The regulation for sustainable finance is furthermore planned to collimate investment management with the UK's sustainable development commitments and their clients' and beneficiaries' penchants over them.[43]

The hard law and soft law provisions and principles introduced to give rise to what is called herein as "regulation for shareholder stewardship" are indicative of references to versifying engagement practices with ESG considerations and using them to uphold sustainable business. FCA-regulated institutional shareholders now must, on a comply-or-explain basis, develop, disclose, and report annually on the implementation of an engagement policy describing, inter alia, engagement practices' part in devising their investment strategy, the exercise of voting rights, and the ways

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40 See European Commission, "The European Green Deal" (2019) COM 640 final; European Commission, "Action Plan: Financing Sustainable Growth" (2018) COM 097 final. Current regulatory steps taken include the Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088; Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector; Regulation (EU) 2019/2089 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks; and Directive (EU) 2022/2464 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting. A proposal for adopting a directive introducing due diligence duties is also under way. See European Commission, "Proposal for a Directive of the European Parliament and of the Council on the Duty of Business Diligence for Sustainability and amending Directive" (EU) 2019/1937, No. 2022/0051. For the initiatives taken at an international level see, inter alia, Net Zero Asset Managers Initiative, https://www.netzeroassetmanagers.org accessed 20 March 2023; UNEP Finance Initiative, About Net-Zero Asset Owner Alliance, https://www.unepfi.org/net-zero-alliance/about/ accessed 20 March 2023; Glasgow Financial Alliance for Net Zero (https://www.gfanzero.com accessed 20 March 2023.

41 Roadmap to Sustainable Investing, p. 31-32; and 2023 Green Finance Strategy, p. 55-60.

42 *ibid.* The FCA has already proceeded in making amendments in its Listing Rules for companies to be making climate change disclosures aligned with the recommendations of the Task Force for Climate-related Financial Disclosures. See Listing Rules, Rule 9.8.6R(8). An ESG sourcebook has also been created. Following the provision of powers under the Pensions Schemes Act 2021, regulations were adopted that are relevant to dealing with ESG considerations and the governance of them by pension trustees. See Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 (SI 2021/839) ('CCGR Regulations'); and The Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021 (SI 2021/857).

43 *ibid.* The FCA is currently consulting on introducing rules aspired to bring the sustainable disclosure requirements regime up. See FCA, "Sustainability Disclosure Requirements (SDR) and investment labels" (Consultation Paper CP22/20, October 2022) ("Consultation Paper CP22/20").

investee companies are monitored for their strategy, capital structure, financial and non-financial performance, and their social and environmental impact.[44] Somewhat similarly, trustees of trust-based pension funds must encompass in the Statement of Investment Principles ("SIP") developed and report on the implementation of an engagement policy.[45] In contrast to the provision applicable on FCA-regulated institutional shareholders, the requirement does not prescribe much on the policy's content save for requiring detailed elaboration on their method of engagement and the process of exercising voting rights. Nevertheless, there is an additional requirement for containing in the SIP the policies developed to factor ESG considerations, which can possibly cover the means engagement practices are au fait with them.[46] Insurers must furthermore disclose the main features of their investment strategy, determine their consistency with the nature of their liabilities, and the way they contribute to the medium to long-term performance of their assets.[47] Asset owners must also disclose how their arrangements with asset managers (if any) correspond with their investment strategy, and provide information for (or give reasoned explanations for the absence of any), inter alia, the incentives given for engaging with investee companies to improve their medium to long-term financial and non-financial performance.[48] Asset managers must reciprocally disclose the approximation of their investment management with asset owners' investment strategy, and its contribution to the medium to long-term performance of their assets or the collective fund asset owners' assets are pooled, informed by elements vis-à-vis shareholder engagement, conflicts of interest, financial or non-financial risks, and investee companies' medium to long-term financial and non-financial performance.[49]

The 2020 Stewardship Code in turn envisions all stewardship activities to create "long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and the society".[50] The application of its principles is forecasted to encourage engagement practices to be undertaken by following them and the definition given to shareholder stewardship whilst factoring, inter alia, companies' compliance with their respective duties and responsibilities, ESG considerations, and wider systemic risks.[51] Just like its predecessors, the revised Stewardship Code remains grounded to the disclosure of signatories' application of its principles, which now touch upon issues beyond shareholder engagement to include investment management and risk assessment.[52] Compliance with the 2020 Stewardship Code remains voluntary, and signatories

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44 See now COBS, Rules 2.2B.5R-2.2B.8R; Senior Management Arrangements, Systems and Controls Sourcebook, Rules 3.4.4R – 3.4.7R ("SYSC").

45 See now, The Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005/378), Regulation 2.3(c) ("Investment Regulations"); The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (SI 2013/2734), Sch 3 paragraph 30(ca)(i) and (ii) ("Disclosure Regulations").

46 ibid, Regulation 2.3(b).

47 SYSC, Rule 3.4.8R.

48 SYSC, Rule 3.4.9R, Investment Regulations, Regulation 2.3(d).

49 COBS, 2.2B.9R – 2.2B.10R.

50 2020 Stewardship Code, 4.

51 *ibid*. This is in addition to a call for considering, among other parameters, several ESG considerations, including, inter alia, climate change, remuneration, diversity and workforce interests. A number of the principles found in the 2020 Stewardship Code enliven this proposition. See for example, *ibid*, Principle 4, stating that signatories should 'identify and respond to market-wide and systemic risks to promote a well-functioning financial system'.

52 *ibid*, p. 1. 'Purpose and Governance' are governed by Principles 1-5 of the 2020 Stewardship Code. General issues about Investment Management are covered in Principles 5-8 of the 2020 Stewardship Code. Shareholder engagement

retain their discretion in determining how the principles will be upheld.[53] Nevertheless, compliance entails explaining the application of all principles, together with the "outcomes" accruing from it and the actions signatories take to deliver on the policies adopted, with reporting expectations accompanying each principle.[54]

3. The Regime's Normative Imperative about Engagement Practices

The developments outlined above raise several issues germane to corporate sustainability meriting further contemplation. In excogitation to the narrative behind bringing it up as a concept, the calls to inform engagement practices with ESG considerations and use them for supporting sustainable business adds to the confusion over whether shareholder stewardship now chimes the adaptation of public-policy prescriptions for engagement practices to their use for creating better returns, or whether it seeks to expose institutional shareholders to greater accountability over their treatment.[55] Leading academics reckon shareholder stewardship is a concept fashioned by the latter.[56] In spite of broaching its narrative in aggregate/contractarian terms, the argument goes, shareholder stewardship articulates wider responsibilities to be put on institutional shareholders for their use of engagement practices, centred on protecting their clients' and beneficiaries' interests by supporting investee companies' longevity and social welfare generally, with the latter now identifying with causes like sustainable development.[57]

But if shareholder stewardship is indeed sought to impose those responsibilities, the legal milieu introduced to realise its objectives must assist in holding institutional shareholders cordially accountable for their standard of engagement practices. The regulation for shareholder stewardship is predominantly comprised of disclosure requirements demanding transparency over institutional shareholders' practices the application of the 2020 Stewardship Code's principles. Several authors acknowledge the limits in enforcing those responsibilities with introducing disclosure requirements due to the reasons precluding active and responsible engagement practices and the potential threat they pose to kickstarting the market for stewardship and the resulting

and the exercise of voting rights are covered in Principles 9-12 of the 2020 Stewardship Code. Note must be made that the 2020 Stewardship Code makes provisions about a number of service providers as well in a set of separate principles aspired to be applicable on them.

[53] But note, COBS, Rule 2.2.3R.

[54] 2020 Stewardship Code, p. 5-7. On the nature of the apply-and-explain nature of soft-law codes, see, in general, *Aino Asplund*, Lost in Accountability. 'Comply or Explain', 'Apply or Explain' and 'Apply and Explain' in a test: The Barriers to Company Benefit?, International and Comparative Corporate Law Journal 13 (2020), 111.

[55] The question was similarly posed in *Dionysia Katelouzou*, Shareholder Stewardship: A Case of (Re)Embedding Institutional Investors and the Corporation?, in: Beate Sjåfjell/Christopher M. Bruner (ed.) The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, 2019.

[56] *ibid*, 588. See also, *Chiu*, "Governing the Purpose of Investment Management" (fn. 7).

[57] *ibid*, 588-591.Cf *Lorraine E. Talbot*, "Polanyi's Embeddedness and Shareholder Stewardship: A Contextual Analysis of Current Anglo-American Perspectives on Corporate Governance", Northern Ireland Legal Quarterly 62 (2011), 451; *Lorraine E. Talbot*, Corporate Governance and the Political Economy of the Company', in: Beate Sjåfjell, Christopher M. Brunner (ed.), Cambridge Handbook of Corporate Law and Sustainability, 2019; *Bobby V. Reddy*, "The Emperor's New Code? Time to Re-Evaluate the Nature of Stewardship Engagement Under the UK's Stewardship Code" Modern Law Review 84 (2021), 842.

enforcement of the responsibilities through it.[58] It remains to be seen if any change will befall subsequent to the concurrent application of the regulation for sustainable finance. Yet the amalgamated impact of both may take years to manifest, and it is unclear if it will alter the trajectory of institutional shareholders' treatment of engagement practices.[59]

A far deeper concern for the law, and the one the Article dwells on to investigate from the perspective of supporting corporate sustainability, lies in its capacity to establish the normative foundations advising institutional shareholders to carry out periodic engagement practices adhering to those responsibilities. If the law is indeed envisioned to motivate institutional shareholders ascending to corporate-sustainability-related matters via their engagement practices, it must at least permit their presence, if not enforcing them, firmed by coherent qualifications exacting their admissibility and enforceability.[60] The Article opines the main legal regime regulating institutional shareholders' engagement practices following the introduction of the regulation for shareholder stewardship as it interacts with the current and future regulation for sustainable finance provides scope for them to be supportive of corporate sustainability. Yet arguably, the regime does not seem to credibly channel that institutional shareholders should promote corporate sustainability whenever they engage with investee companies or monitor engagement once it is delegated. To unfold the argument, this section elucidates the regime's normative imperative for institutional shareholders' engagement practices.

3.1. Institutional Shareholders' Duties and Other Responsibilities

Since the amendments made to the law are established upon of informed by them, it is prudent to begin pondering what the law provides about how institutional shareholders should approach their engagement practices by first examining institutional shareholders' key duties and other responsibilities to their clients and beneficiaries. Starting with trust-based pension funds, it is clear that pension trustees owe fiduciary duties to the funds' beneficiaries for furthering their best interests per the funds' trust deed when managing investments, an arguable denotation to the fiduciary duties of loyalty, the diligent exercise of power, and due skill and care.[61] Statutory law additionally requires, inter alia, investing assets in service to the best interests of beneficiaries, and

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[58] See, by reference to the regulation for shareholder stewardship, *Johnston/Belinga et al.* (fn. 10); *Andrew Johnston*, Market-Led Sustainability through Information Disclosure, in: Beate Sjåfjell/Christopher M. Bruner (ed.), The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, 2019; *Iris H-Y Chiu*, Disclosure Regulation and Sustainability: Legislation and Governance Implications, in: Beate Sjåfjell/Christopher M. Bruner (ed.), The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, 2019.

[59] See, by reference to the EU initiatives taken, *Dirk A. Zetzsche/Linn Anker-Sørensen*, "Regulating Sustainable Finance in the Dark" European Business Organisation Law Review 23 (2022), 47; and *Dirk A. Zetzsche/Linn Anker-Sørensen*, Towards a Smart Regulation of Sustainable Finance, in: Paulo Câmara/Filipe Morais (ed.), The Palgrave Handbook of ESG and Corporate Governance, 2022.

[60] But see, *Iain McNeil/Irene-Marie Esser*, "From a Financial to an Entity Model of ESG", European Business Organization Law Review 23 (2022), 9.

[61] Law Commission, "Fiduciary Duties of Investment Intermediaries" (fn. 35), p. 108-110. Lord Nicholls extra-judicially suggested that defining a trustee's obligation in the scope of 'acting in the best interests of beneficiaries' is a formulation of a trustee's obligation to promote the purpose for which the trust was created. See *Lord Nicholls of Birkenhead*, Trustees and their Broader Community: Where Duty, Morality and Ethics Converge, in: M. Scott Donald/ Lisa Butler (ed.), The Evolving Role of Trust in Superannuation Law, 2017, p. 148.

exercising investment power in calculation of the security, quality, liquidity and profitability of the investment portfolio.[62] Pension trustees should furthermore develop and make available an SIP subject to the rules regulating its content, and exercise their power to give reasonable effect to it.[63] Recent reforms have introduced additional provisions requiring large trust-based pension funds to, inter alia, detect and report on climate-related risks and opportunities likely to impact their investment strategy, establish oversight for ensuring the same applies for persons acting on their behalf, commence scenario analysis assessing the impact of climate-related risks, and establish processes identifying such risks using key metrics.[64]

Provided they comply with these, pension trustees are afforded with substantial discretion over investment management. They may deem engagement practices should or should not be extensive, and they may decide to further causes like corporate sustainability.[65] They furthermore have the flexibility to decide whether shareholder engagement is to be conducted in-house or outsource it to an asset manager.[66] Most likely, pension trustees will assign shareholder engagement to an asset manager alongside other investment management tasks through an investment management agreement ('IMA').[67] The IMA may contain provisions in consonance with the SIP, and can in theory contain provisions dealing with shareholder engagement.[68]

No statutory qualifications delineate how these duties and responsibilities apply in the context of shareholder engagement and its monitoring once delegated. Case law is not helpful either. Only a handful of cases dealt with the 'best interests' principle, but without giving a solid appreciation on its application on them.[69] In one of its reviews in the area, the Law Commission reasoned that trustees' duties and responsibilities highlight the advancement of the trust's purpose, namely the provision of pensions and other benefits to beneficiaries upon retirement.[70] Within the confines of the law and the trust deed, the Law Commission stated, pension trustees must exercise their

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[62] Investment Regulations, Regulations 4(2) and 4(3).
[63] Pensions Act 1995, s. 35 - 36.
[64] CCGR Regulations, Regulation 3 and Schedule, Part 1.
[65] Law Commission, "Fiduciary Duties of Investment Intermediaries" (fn. 35), p. 101-108, 109.
[66] Note though Pensions Act 1995, s. 47(2).
[67] In such instances, the asset manager will have to comply with the provisions contained in the Pensions Act and the Investment Regulations. See Pensions Act 1995, s.36(1); and Investment Regulations, Regulation 4(1).
[68] Note though, *ibid.*
[69] The most notable case cited on this matter is *Cowan v Scargill* [1985] Ch 270 (High Court). In the case, Megarry VC interpreted the 'best interests' principle to be expressing the prioritisation of beneficiaries' interests. On the facts of the case, the best interests of beneficiaries were taken to be meaning furthering primarily their financial interests. Bearing in mind the purpose of the trust in question, investment powers were ruled they should have been exercised to yield optimally risk-adjusted returns for beneficiaries. The only exception found for diverting from the aforementioned in the case was in the integration of beneficiaries' non-financial interests. See in *Cowan*, 287-288. The case sparked controversy because of its interpretation as validating unbridled profit maximisation. A report conducted by Freshfields in 2005 has stated *Cowan v Scargill* should be read as an authority binding on its facts. See UNEP Finance Initiative, "A Legal Framework for the Integration of Environmental, Social and Governance issues into Institutional Investment" (October 2005), p. 89. Relevant consideration was given by Megarry VC on this point in *Cowan* as well, at 288. Other key cases dealt with the 'best interests' principle, but they did not prove insightful. See *Harries v The Church Commissioners for England* [1992] 1 WLR 1241 (Hight Court); and *Martin v City of Edinburgh District Council* [1989] 1988 SLT 329 (Ct Sess).
[70] Law Commission, "Fiduciary Duties of Investment Intermediaries" (fn. 35), p. 108-114, citing *Lord Nicholls of Birkenhead* (fn. 61).

unfettered discretion and due diligence when managing investments for the said purpose in accordance with the SIP for the best interests of their beneficiaries.[71] Factoring ESG considerations in decision-making were seen by the Law Commission as justiciable and justifiable when they are, on broad economic grounds, financially material to furthering ulteriorly the trust's purpose and the performance of investments made or about to be made.[72] Where pension trustees think ESG considerations are financially material, the Law Commission reasoned, trustees should take them into account. Consideration of non-financially material ESG considerations was also seen to be permissible, but only when trustees have good reason to think beneficiaries would share their convictions or when there will not be a risk of significant financial detriment unless expressly articulated in the trust deed or explicitly consented by beneficiaries.[73]

The Law Commission, however, found no duty or authority necessitating pension trustees to engage with investee companies or obligating engagement practices to abide by any standard save for the Stewardship Code in force at the time.[74] Regardless, the Law Commission concurred with previous reports on the possibility for frequent and responsible engagement practices broached in the shareholder stewardship lexicon to be in beneficiaries' best interests.[75] The Law Commission additionally stated all pension trustees can now be involved in engagement activities either directly or indirectly via monitoring their in-between arrangements with asset managers on it.[76] Nevertheless, the Law Commission noted pension trustees' discretion on their undertaking, and signified compliance with the law even when pension trustees stop short of delegating shareholder engagement and monitoring it.[77] Case law signifies some liability for failing to utilise a controlling shareholding position in an investee company.[78] But for the Law Commission, the obligation arises solely in situations similar to the precedent bringing the principle up.[79]

Clarity over shareholder engagement and its respective monitoring does not fare better in the case of insurers, asset managers, and contract-based pension funds. These institutional shareholders are

[71] *ibid.*

[72] *ibid*, p. 111-114. For academic opinion on the point see, *Andrew Johnston/Paige Morrow*, "Fiduciary Duties of European Institutional Investors: Legal Analysis and Policy Recommendations" University of Oslo Faculty of Law Research Paper No. 2016-04, 2016, https://ssrn.com/abstract=2783346 accessed 12 April 2023; *Benjamin J. Richardson*, "Do the Fiduciary Duties of Pension Funds Hinder Socially Responsible Investment?", Banking and Finance Law 22 (2007), 145; and *Benjamin J. Richardson*, "From Fiduciary Duties to Fiduciary Relationships for Socially Responsible Investing: Responding to the Will of Beneficiaries", Journal of Sustainable Finance & Investment 1 (2011), 5.

[73] *ibid.* The Law Commission outlined some examples where consideration of non-financially material ESG considerations would be permissible. It included, "decisions aimed at improving beneficiaries 'quality of life'", "decisions aimed at showing disapproval of unethical conduct", and "decisions aimed at improving the UK economy". The PRI, UNEP Finance Initiative and the Generation Foundation launched a project titled 'Fiduciary Duty in the 21st Century', dedicated to providing clarifications on the topic further across jurisdictions. The group published a series of key reports. See, for example, UNEP Finance Initiative/PRI, "Fiduciary Duty in the 21st Century: Final Report" (2019).

[74] *ibid*, p. 101-108.

[75] *ibid*, p. 105, citing Myners Report, paras 5.90-5.91.

[76] *ibid*, p. 101-107.

[77] *ibid.*

[78] See *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515 (Court of Appeal).

[79] Law Commission, "Fiduciary Duties of Investment Intermediaries" (fn. 35), p. 106.

organised and structured polymorphically, and their affiliation with clients is usually contractual.[80] Notwithstanding, these institutional shareholders operate in a highly regulated area. Asset managers engaged by trust-based pension funds, for example, should manage investments in concord with the mandate provided under the IMA, uphold the SIP, and invest on their behalf for the furtherance of the best interests of their beneficiaries.[81] The FCA additionally imposes rules and requirements touching upon their conduct of business by instituting principles for it and disclosure requirements estimated to guarantee the proper functioning of financial markets, with rules making up the regulation for shareholder stewardship and sustainable finance applicable on them being part of them.[82] Several of these are found in the FCA's Handbooks, and must be followed in compliance with principles established by it. In the eyes of the Law Commission, these principles bear similarities in substance to pension trustees' duties.[83] Some of these principles prescribe, inter alia, the exercise of due skill and care and the perpetuation of clients' best interests.[84] Several providers of contract-based pensions are additionally required to have in place an independent governance committee assessing, inter alia, a firm's 'stewardship', defined broadly to encapsulate both shareholder engagement and its respective monitoring once it is delegated.[85]

Like trust-based pension funds, these institutional shareholders are given wide discretion over investment management and shareholder engagement, and there is no cogent guidance over how they should be undertaken.[86] Notwithstanding, the FCA recently stated in a joint report with the DWP that engagement practices informed by ESG considerations are both permissible under its principles and desirable, in addition to acknowledging that ESG considerations should inform decision-making whenever they are financially material or when they are deemed material in assessing their long-term impact on clients' financial interests.[87] No account was provided over living up to the task though. FCA-regulated institutional shareholders are left to their own volition for determining the level and scope of their engagement practices depending on their business models and investment strategy adopted in unison with any mandates received and the interests

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[80] For a critical account of contract law and theory of contract law see *David Campbell*, Contractual Relations: A Contribution to the Critique of the Classical Law of Contract, 2022.

[81] Pensions Act s 36(5); Investment Regulations, Regulation 4(1). Asset managers engaged by UCITs are regulated with regards to their conduct of business. Part of the rules entail to consider how voting in investee companies and several forms of shareholder engagement are to be carried with a view to secure the best interests of the funds in question. See Collective Investment Schemes, Rule 6.6A.6R.

[82] The FCA as of the time the Article is written is consulting on the development of a package of measures aimed to realise the regulation for sustainable finance. See Consultation Paper CP22/20.

[83] Law Commission, "Fiduciary Duties of Investment Intermediaries" (fn. 35), p. 159; Law Commission, "Pension Funds and Social Investment" (fn. 35), p. 34.

[84] Principles for Businesses, Rule 2.1.1R ("PRIN"); COBS, Rule 2.1.1R contains the regulatory equivalent of a 'best interests' duty: 'A firm must act honestly, fairly and professionally in accordance with the best interests of its client'. Note however, PRIN, Rule 3.4.4R.

[85] COBS, Rule 19.5.1BG. Definition of 'stewardship' of the purposes of the rule is found in COBS Rule 19.5.1AR. Note must be made that COBS 19.5 provides that firms providing smaller and less complex pension schemes are allowed to establish a governance advisory arrangement as an alternative to an IGC, subject to specific rules contained therein.

[86] Law Commission, "Fiduciary Duties of Investment Intermediaries" (fn. 35), p. 149-151. See also, COBS, Rule 2.1.3G(1).

[87] Department for Digital, Culture, Media & Sport/DWP, "Pension Funds and Social Investment: The Government's Final Response" (June 2018).

of their clients and beneficiaries.[88] The FCA is currently consulting on enacting a disclosure-requirements-based regime dedicated to reducing 'greenwashing' alongside the introduction of sustainable investment labels, a rule for avoiding greenwashing, and restrictions in the use of sustainability-related terms in investment product naming and marketing. Many of the provisions about the imposition of the labels suggest having stewardship as a criterion for verbalizing the maintenance, management and dedication of resources in consistency with the label suggested to be provided.[89]

3.2. Regulation for Shareholder Stewardship

Operating in the shadow of institutional shareholders' duties and responsibilities referred above, the regulation for shareholder stewardship in interaction with the current and future regulation for sustainable finance brings about the tip of the spear of the regulation of institutional shareholders' engagement practices. The provisions and principles comprising it do not provide any legally binding qualifications dictating any objectives to be pursued through any engagement practices. As mentioned above, the provisions are mostly disclosure requirements demanding statements about institutional shareholders' approach to engagement practices and, in the case of the 2020 Stewardship Code, the furtherance of its soft law principles. The transpiration of the market for stewardship is in turn estimated to enforce specific actions based on the disclosures made.

Notwithstanding, a key parameter betokens the worth of delineating the provisions' part in what the law provides about how institutional shareholders should undertake their engagement practices. Compliance with the regulation for shareholder stewardship should naturally entail institutional shareholders taking some form of action to make any disclosures on them or elaborate (wherever applicable) the reasons they did not.[90] Policymakers and regulators via the regulation for shareholder stewardship incline to impose a range of expectations onto institutional shareholders about complying with the provisions by adopting certain conduct believed to be optimal.[91] This is especially the case with the 2020 Stewardship Code, since signatories are anticipated to make disclosures indicating the application of its principles.[92] If properly enforced in the form of demand by the market for stewardship, compliance with the regulation for shareholder stewardship in

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[88] See also, FCA, "Climate Change and Green Finance" (Discussion Paper DP18/8 October 2018); FCA, "Climate Change and Green Finance: summary of responses and next steps - Feedback to DP18/8" (Feedback Statement FS19/6, October 2019).

[89] See Consultation Paper CP22/20.

[90] This has been argued that it creates expectations which do not fall far from creating a 'duty to engage'. See *Iris H-Y Chiu/Dionysia Katelouzou*, From Shareholder Stewardship to Shareholder Duties: Is the Time Ripe?, in: Hanne S. Birkmose (ed.), Shareholders' Duties, 2017, p. 143. Cf *Deirdre Ahern*, "The Mythical Value of Voice and Stewardship in the EU Directive on Long-Term Shareholder Engagement: Rights Do Not an Engaged Shareholder Make", Cambridge Yearbook of European Legal Studies 22, 88.

[91] But see, *Hanne S. Birkmose*, "From Shareholder Rights To Shareholder Duties – A Transformation of EU Corporate Governance In a Sustainable Direction?" Journal for the International and European Law, Economics and Market Integrations 5 (2018), 69; *Hanne S. Birkmose*, Duties Imposed on Specific Shareholders Only, and Enforcement Implications, in: Hanne S. Birkmose/Konstantinos Sergakis (ed.), Enforcing Shareholders' Duties, 2019.

[92] *Chiu*, "Governing the Purpose of Investment Management" (fn. 7). On the expectations articulation, see FRC, "The UK Stewardship Code Review of Early Reporting" (September 2020).

discharge of these expectations can (theoretically) compel institutional shareholders living up to them.

Viewed like so, the regulation for shareholder stewardship arguably prescribes implicitly certain conduct to be carried out subject to the wants of the market for stewardship. An examination of the regulation for shareholder stewardship and regulators' resolve behind its introduction suggest the existence of a range expectations about shareholder engagement and its monitoring.

3.2.1. Presence of Engagement Practices

A reading of the provisions in conjunction with reports and consultation documents which led to them being brought up first point that the regulation for shareholder stewardship is aimed to implicitly impress on institutional shareholders that they should at least consider engaging with investee companies, if not being keenly hands-on engaging, or actively monitoring the delegation of it.[93] It should be remembered that the engagement policy provisions entail developing and disclosing an engagement policy or, if possible (at least for FCA-regulated institutional shareholders), explaining the reasons alternative arrangements justify its absence. For compliance to manifest, institutional shareholders are awaited to at least ponder whether engagement practices should comprise their investment strategy.[94] In the case they decide for their presence, institutional shareholders should disclose their approach to them as per the provision applicable on them.[95] As for the case where institutional shareholders decide not to be entangled with shareholder engagement (which on its face seems to be an option for FCA regulatees), they should explain how the same elements make engagement practices undesirable.[96]

Should engagement practices be deemed to be present, the requirement to report on the engagement policy's implementation is prospected to present institutional shareholders' commitment to it, and it is anticipated that it will induce engagement practices' undertaking. The transparency requirements for the in-between arrangements of asset owners and asset managers

[93] The argument for the existence of the expectation is found in various authors in the literature. See for example, *Hanne S. Birkmose*, Article 3G: Engagement Policy, in: Hanne S. Birkmose/Konstantinos Sergakis (ed.), The Shareholder Rights Directive II : A Commentary, EE, p. 145 - 146, citing European Commission, "Green Paper: Corporate Governance in Financial institutions and Remuneration Policies" COM (2010) 284 final, 8. See also, *Konstantinos Sergakis*, "EU Corporate Governance: A New Supervisory Mechanism for the 'Comply or Explain' Principle?", European Company and Financial Law Review 3 (2010), 401; *Dionysia Katelouzou*, Reflections on the Nature of the Public Corporation in an Era of Shareholder Activism and Shareholder, in: Barnali Choudhuri/Martin Petrin (ed.), Understanding the Company: Corporate Governance and Theory, 2017.

[94] See, by reference to commenting on SRDII provisions as stated in SRDII, *Birkmose*, Article 3G (fn. 109), p. 146. The expectation appears in certain respects in several reports and consultations done in the UK for introducing the regulation for shareholder stewardship. See, for example, Discussion Paper DP19/1, p. 11-16; Feedback Statement FS19/7, 12. FCA, 'Consultation on proposals to improve shareholder engagement' (Consultation Paper CP19/7, January 2019), p. 14-15 ('Consultation Paper CP19/7'); DWP, 'Clarifying and Strengthening Trustees' Investment Duties: Government Response - The Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2018 (now the Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018) (September 2018), p. 23-28.

[95] *ibid*, p. 146-149.

[96] *ibid*.

may reinforce such inducement.[97] The provisions can elicit information about the mandates given to asset managers for shareholder engagement and can put pressure for it to be periodic. If not engaging directly, asset owners can equally be led towards committing themselves to giving relevant mandates to asset managers, and actively monitor their actions.[98] Regulators and policymakers do not seem to expect engagement practices being undertaken 'out of context'.[99] In addition to statements made by regulators in the UK and the EU in validation of this,[100] the provisions applicable on FCA-regulated institutional shareholders provide for giving descriptions over how shareholder engagement comprises the main elements of their investment strategy.[101] The engagement policy in the case of trust-based pension funds is also required to form part of the SIP which must inform trustees' investment management.[102]

The application of the 2020 Stewardship Code's principles is sought to inculcate the idea of having in place active engagement practices more forcefully.[103] The 2020 Stewardship Code's apply-and-explain nature of its principles' application involves explaining the placement of shareholder stewardship's advent in signatories' purposes, values, and internal governance arrangements.[104] With them taking centre stage in what takes to exercise 'shareholder stewardship', engagement practices are not only deemed to be apparent, but also form part of signatories' investment management, whose disclosures should clarify this. Conforming with the principles of the 2020 Stewardship Code is additionally awaited to incentivise signatories to take up engagement practices in collaboration with other shareholders or escalate engagement practices.[105] There is, though,

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[97] See specifically on this, from the perspective of the FCA, Consultation Paper CP19/7, p. 14-15; and DWP, 'Consultation Outcome - Reporting on Stewardship and Other Topics through the Statement of Investment Principles and the Implementation Statement: Statutory and Non-Statutory Guidance (Updated 17 June 2022) https://www.gov.uk/government/consultations/climate-and-investment-reporting-setting-expectations-and-empowering-savers/outcome/reporting-on-stewardship-and-other-topics-through-the-statement-of-investment-principles-and-the-implementation-statement-statutory-and-non-statutory#the-sip-trustees-taking-ownership-of-stewardship accessed 20 March 2023 ("DWP Consultation Outcome"). Cf findings in *Suren Gomtsian*, "Voting Engagement by Large Institutional Investors" Journal of Corporation Law 45 (2020), 659.

[98] *ibid.* See on this point, *Johnston/Belinga et al.* (fn. 10), 62.

[99] See on this, *Hanne S. Birkmose*, Article 3h: Investment Strategy of Institutional Investors And Arrangements With Asset Managers, in: Hanne S. Birkmose/Konstantinos Sergakis (ed.), The Shareholder Rights Directive II : A Commentary, 2021.

[100] See, for example, Consultation Paper CP19/7, at p. 1: "Stewardship also has a role to play across a variety of investment strategies and approaches. To the extent that it improves market quality, stewardship can make markets function better for all users". See also DWP Consultation Outcome; Commission Impact Assessment, at p. 46-47; SRDII, [17] – [24].

[101] COBS, Rules 2.2B.5R-2.2B.8R; SYSC, Rules 3.4.4R – 3.4.7R.

[102] Investment Regulations, Regulation 2.3(b). Note also Pensions Act 1995, s. 36(5).

[103] But see *Paul Davies*, The UK Stewardship Code 2010–2020 From Saving the Company to Saving the Planet?, in: Dionysia Katelouzou/Dan Puchniak (ed.), Global Shareholder Stewardship, 2022, p. 57-58.

[104] 2020 Stewardship Code, Principles 1-5. See discussion on this, *Chiu*, "Governing the Purpose of Investment Management" (fn. 7) citing *Asplund* (fn. 54) and *Parmi Natesan*, "The Evolution and Significance of the 'Apply and Explain' Regime in King IV", Journal of Global Responsibility 11 (2020), 135.

[105] 2020 Stewardship Code, Principles 9 - 12.

scope for deviation on these. The 2020 Stewardship Code is accommodative of any type of engagement and allows escalation and collaboration whenever necessary.[106]

Compliance with the regulation for shareholder stewardship is awaited to generate disclosures providing cogent explanations about the methods used or to be used for any engagement practice. The engagement policy disclosed by FCA regulatees must describe, non-exhaustively, the methods implemented to monitor investee companies, conduct dialogue with investee companies, exercise their voting rights, cooperate with other shareholders, communicate with relevant stakeholders and manage conflicts of interest.[107] The provisions applicable on pension trustees do not provide anything on these, although the DWP and the Pensions Regulator direct policies to explain the modes and methods used to adopt any engagement practice.[108] In case shareholder engagement is delegated, the DWP and the Pensions Regulator look forward from trustees to take 'ownership' of their policies.[109] Trustees are awaited to disclose the priorities set for shareholder engagement in their SIP and provide links to asset managers' policies on them. The DWP additionally noted asset manager selection and their expression of wishes to asset managers individually or collectively with other clients as a good form of engagement.[110] Signatories to the 2020 Stewardship Code are equally estimated to act similarly. Their disclosures should explain the goals pursued, the methods and mode chosen to engage or monitor engagement, and the reasons behind their chosen approach.[111]

Some forms of engagement may prove problematic for institutional shareholders. Conducting dialogue with investee companies may possibly make institutional shareholders holders of inside information.[112] The use of proxy advice and stock lending may also impede the efficiency of shareholder engagement.[113] Co-operation with other shareholders necessitates overcoming collective action problems, whose severity fluctuates.[114] None of the provisions or the guidance provided so far has key answers to circumventing these. The regulation for shareholder stewardship is anticipated to generate disclosures elaborating institutional shareholders' approach

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[106] Ibid, Principle 10: "Signatories, where necessary, participate in collaborative engagement to influence issuers". It is expected that signatories 'should disclose what collaborative engagement they have participated in and why, including those undertaken directly or by others on their behalf' and describe the outcomes of their collaborative engagement. See also Principle 11: "Signatories, where necessary, escalate stewardship activities to influence issuers".

[107] COBS, Rule 2.2B.6R; SYSC, Rule 3.4.5R.

[108] DWP Consultation Outcome, paras 40-55; Pensions Regulator, "DC Investment Governance" (fn. 39); Pensions Regulator, 'DB Investment Governance' (fn. 39).

[109] *ibid*. See also in DWP Consultation Outcome, paras 68-71 (addressing the implementation statements imposed).

[110] *ibid*.

[111] 2020 Stewardship Code, Principles 9-11.

[112] See on this *Chiu*, "Turning Institutional Investors into 'Stewards'" (fn. 12); and *Iris H-Y Chiu*, "Institutional Shareholders as Stewards: Toward a New Conception of Corporate Governance", Brooklyn Journal of Corporate, Financial & Commercial Law 6 (2012), 387.

[113] See on this, *Konstantinos Sergakis*, "The UK Stewardship Code: Bridging the Gap Between Companies and Institutional Investors" Revue juridique Thémis de l'Université de Montreal 47 (2013), 109.

[114] See generally on the issue, *Rafael Savva*, "Shareholder Power As An Accountability Mechanism: The 2017 Shareholder Rights Directive And The Challenges Towards Enhancing Shareholder Rights", Journal for the International and European Law, Economics and Market Integrations 5 (2018), 277.

to shareholder engagement or the monitoring of its delegation in response and in reconnaissance to them.[115]

In several provisions and in consultation documents, reports, and guidance provided, statements made about investee-company monitoring point to monitoring investee companies' financial and non-financial performance, including their social and environmental impact.[116] The list of issues invited to be monitored is non-exhaustive, and institutional shareholders have the discretion to tackle all or some of them. Most of the issues raised typically fall within the remit of investee companies' directorial control.[117] Investee-company monitoring typically entails checking directors' compliance with their duties and responsibilities based on the reporting produced. It is not clear, however, whether monitoring is expected to extend yonder of what is being reported in compliance with directors' duties and responsibilities. Given shareholder stewardship's inception upon seeing shareholder engagement being complementary to the board's authority when it comes to governing companies, it is most likely not the case.[118]

The regulation for sustainable finance is intended to assist institutional shareholders with the uptaking of their engagement practices for issues connected to ESG considerations and corporate sustainability-related matters. The forthcoming taxonomy will articulate the criteria classifying specific business or financial products as 'sustainable', providing common definitional tools discerning the degree the said business or products are indeed contributory to sustainable development.[119] Current and future sustainability disclosure requirements project to require companies and the institutional investment community to report against the taxonomy. The requirements are envisaged to give the information institutional shareholders need to easily compare performance against the disclosures and use them as yardsticks for their engagement.[120] The sustainability disclosure requirements regime is also estimated to give an impetus to institutional shareholders for internalising these in engagement practices, helping hence clients and beneficiaries determine whether their assets are managed in mind of relevant ESG considerations.[121]

While it remains to be seen how regulation for sustainable finance will morph institutional shareholders' approach to engagement and its monitoring, policymakers and regulators through

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[115] See, for example, guidance given by DWP Consultation Outcome, paras 40-55, 68-71.

[116] ibid; Consultation Paper CP19/7, p. 13-14; Discussion Paper DP19/1, p. 3; Feedback Statement FS19/7, p. 11-16; Commission Impact Assessment, p. 45-50; SRDII, [17] – [24].

[117] See on this, generally, *Beate Sjåfjell*, "Why Law Matters: Corporate Social Irresponsibility and the Futility of Voluntary Climate Change Mitigation" European Company Law 8 (2011), 56.

[118] See Walker Review, p. 79-80. However, concluding remarks by the Roadmap to Sustainable Investing suggest otherwise, raising some confusion about this. See Roadmap to Sustainable Investing, at p. 30: "Stewardship can be a powerful vehicle to hold companies to account for the feasibility and credibility of their net-zero commitments, and their transition strategies to align their business models with a net-zero economy. Investors also decide how capital is allocated, for example to companies and technologies that contribute to these ambitions".

[119] *ibid*, p. 24. According to the Roadmap to sustainable investing, a business activity is going to be 'sustainable' per the UK Taxonomy, the activity will have to make a substantial input to attaining the environmental objectives set by the government, avoid doing significant harm to other environmental objectives and fit with minimum safeguards in line with OECD's Guidelines for Multinational Enterprises and the UN's General Principles on Business and Human Rights.

[120] *ibid*, p. 10-19.

[121] *ibid*, p. 30-32. Consultation Paper CP22/20.

the regulation for shareholder stewardship envisage institutional shareholders conducting themselves in notation to those elements. As noted in Section 2, the hard-law provisions of the regulation for shareholder stewardship make several references to informing engagement practices with ESG considerations. Engagement practices per the 2020 Stewardship Code should also endeavour to create 'sustainable outcomes for the economy, the society and the environment'.[122] No cogent guidance is given for the kinds of outcomes awaited to accrue. Regardless, ESG considerations are expected to form part of the issues that ought to animate shareholder engagement and its respective monitoring. Institutional shareholders are awaited to detect and respond to systemic risks via their stewardship activities, investment, and internal governance structures advancing a good financial system and the needs of their clients and beneficiaries.[123] They must furthermore explain their relevant approach to detecting and responding to those risks as well as their work with others to address them.[124]

3.2.2. Scope and Objective of Engagement Practices

Given it is set to apply subject to institutional shareholders' key duties and responsibilities to their clients and beneficiaries, the regulation for shareholder stewardship does not seem to be contemplated as instilling onto institutional shareholders that they should adopt engagement practices in breach of them.[125] The hard-law provisions of the regulation for shareholder stewardship are placed within existing regulation applicable on institutional shareholders, where compliance with it should be in execution of the said duties and responsibilities. The 2020 Stewardship Code does dictate shareholder stewardship should inform signatories' purposes and governance arrangements, in addition to finding and providing responses to market-wide and systemic risks.[126] But apart from identifying the purpose of shareholder stewardship primarily with the creation of long-term value for clients and beneficiaries, signatories are anticipated to manage investments, stewardship activities and conflicts of interest by putting the interests of their clients and beneficiaries first.[127]

Still though, this expectation does not come unqualified, for it is supplemented by the anticipation of seeing institutional shareholders resonating with shareholder stewardship's ideal for shareholder

[122] 2020 Stewardship Code, p. 1.

[123] *ibid*, Principles 4 and 7.

[124] *ibid*. See also Principle 5.

[125] Several remarks in reports and consultations made exemplify this. See, for example, Feedback Statement FS19/7, at p. 12: "We think it is important to acknowledge the role that effective stewardship can play in promoting better economic, environmental and societal outcomes. However, we recognise these outcomes may be indirect, flowing from pursuing sustainable financial returns for clients and beneficiaries"; Policy Statement PS19/13, at p. 5: "Effective stewardship supports consumers by better aligning incentives across the institutional investment community with the long term interests of consumers of financial services. Consumers will also benefit from better information flow across the institutional investment community about how firms engage with issuers to promote their interests"; and, SRDII, at [19]: "…This would contribute to a proper alignment of interests between the final beneficiaries of institutional investors, the asset managers and the investee companies and potentially to the development of longer-term investment strategies and longer-term relationships with investee companies involving shareholder engagement".

[126] 2020 Stewardship Code, Principles 1-4. References to these is made in the DWP's consultation provided for trust-based pension funds as well. See DWP Consultation Outcome, paras 25-33, 38-40, 46, and 53.

[127] *ibid*, Principles 6 and 7.

engagement and its monitoring.[128] It was mentioned above that the hard-law provisions have been arguably introduced in anticipation of seeing engagement practices to be another element of an investment strategy institutional shareholders will at least cogitate adding to their own. The investment strategy provision applicable on insurers in turn requires them to disclose the contribution of the main elements of their investment strategy to the medium to long-term performance of their assets and the main incentives given to asset managers for orienting their investment strategy with their own.[129] The provision leaves ample ground for an implicit expectation for disclosures to reveal the utilisation of engagement practices to the end outlined, while the notation to the assets' "medium to long-term performance" seems to be a signpost to the assets' financial performance measured in view of all relevant financial and non-financial matters affecting it.[130] Asset managers should also disclose how the elements of their investment strategy contributes to the medium to long-term performance of asset owners' assets or of the collective fund their assets have been pooled, resounding arguably a similar expectation.[131] Pension trustees' provisions do not make these references. Notwithstanding, it is possible to see the expectation arising with the delegation of shareholder engagement to asset managers and the reciprocal calls for its monitoring.[132] The 2020 Stewardship Code finally envisages shareholder engagement to be promotive of shareholder stewardship's goals, tapping clearly on value creation for clients and beneficiaries.[133]

The specific outcomes engagement practices should pursue in adherence to shareholder stewardship's ideal for them are not exact. Notwithstanding, it is possible to argue the provisions create a spectrum of outcomes institutional shareholders hold discretion to further.[134] Since the hard-law provisions are sought to act as a 'regulatory baseline' providing transparency over how

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[128] See discussion in Section 2, above. Note must be made that this anticipation resonates more with UK policymakers' intentions and aspirations, see Feedback Statement FS19/7, p. 9-11. The narrative used at an EU level to promote responsible and frequent shareholder engagement does not differentiate much from shareholder stewardship's equivalent one, see, SRDII, [19]; and Commission Impact Assessment, at p. 46-47. Birkmose makes an argument for the rise of an implicit expectation for engagement aiming to strive to touch upon issues of corporate governance with a view to improve the medium to long-term performance of the assets and the investee companies. See *Hanne S. Birkmose*, Institutional Investors and Sustainable Finance – Developing the Shareholder Engagement Framework in Light of the Emerging Sustainable Finance Regime in the EU, in: Iris H-Y Chiu/Hans Christoph Hirt (ed.), Investment Management, Stewardship and Sustainability: Transformation and Challenges in Law and Regulation, 2023. The infusion of both in the context of shareholder stewardship's ideal came in view of the FRC's and the FCA's intention to transpose the SRDII provisions to create a 'regulatory baseline' for shareholder stewardship. See Discussion Paper DP19/1, p. 3.

[129] SYSC, Rules 3.4.8R-3.4.9R.

[130] See a similar argument made by *Birkmose*, Article 3h (fn 99), p. 166-168, 170.

[131] COBS, Rule 2.2B.9R. See on this, generally, *Suren Gomtsian*, Article 3i: Transparency of Asset Managers, in: Hanne S. Birkmose/Konstantinos Sergakis (ed.), The Shareholder Rights Directive II : A Commentary, 2021.

[132] In fact, the DWP in its guidance states that it is expected of pension trustees to act alike, to the extent it is possible, even when it comes to monitoring engagement that is delegated to asset managers. See DWP Consultation Outcome, paras 38-64.

[133] 2020 Stewardship Code, p. 1-3. At p. 5, the 2020 Stewardship Code additionally mentions signatories must take in account, inter alia, the effective application of the UK Corporate Governance Code and other governance codes; directors' duties, particularly those matters to which directors must have regard under section 172 of the Companies Act 2006; capital structure, risk, strategy and performance diversity, remuneration and workforce interests; audit quality; environmental and social issues, including climate change; and compliance with covenants and contracts.

[134] DWP makes this point in DWP Consultation Outcome, paras 45-46.

institutional shareholders reach the goals of shareholder stewardship, it can be argued that institutional shareholders are envisioned to at least adopt engagement practices contributing to the medium to long-term performance of the assets held, factoring all relevant issues capable of affecting it.[135] In envisioning the 2020 Stewardship Code giving 'higher standards' for them, policymakers may seek to see signatories adopting engagement practices which come in line with the definition the 2020 Stewardship Code gave for shareholder stewardship, namely the creation of long-term value for clients (presumably arising from the long-term performance of the assets held), leading to sustainable benefits overall.[136]

Having in mind the narrative giving life to shareholder stewardship's ideal for them, the expectation to see engagement practices upholding the ideal and the references made to 'long-term value creation', the 'medium to long-term performance of assets' and others arguably resound having shareholder value creation and estimates made for it acting as the guiding lights for assessing and determining engagement practices' scope and objectives while factoring parameters affecting it, including ESG considerations. Several statements made in consultations and reports validate the account.[137] Yet there is limited explanation confirming its rationale besides insinuating that such engagement practices can discharge institutional shareholders' duties and responsibilities in line with clients' and beneficiaries' investment horizons and wants in the long-term.[138] A cautious observation to the theoretical trestle that shareholder stewardship's narrative for shareholder engagement is instituted upon, though, leads in appreciating that the emphasis put on adopting engagement practices led by shareholder-value creation may derive from the respective faith policymakers and regulators put on such decision-making and estimates made around it to advance obliquely corporate longevity and social welfare on the strength of the theoretical trestle's holding.[139]

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[135] *Dionysia Katelouzou/Konstantinos Sergakis*, "When Harmonization is Not Enough: Shareholder Stewardship in the European Union", European Business Organisation Law Review 21 (2021), 203, 229.

[136] *ibid*, 230.

[137] References to this are made, for example, in Feedback Statement FS19/7, at p. 12-13: "We think it is important to acknowledge the role that effective stewardship can play in promoting better economic, environmental and societal outcomes. However, we recognise these outcomes may be indirect, flowing from pursuing sustainable financial returns for clients and beneficiaries"; and at p. 14: "In line with much of the feedback, we consider that for many firms stewardship will be an integral part of their strategy to deliver longterm sustainable value creation, in the best interests of their clients and beneficiaries. The focus of stewardship will then be determined by this long-term objective. It will therefore typically include careful consideration of ESG factors, consistent with the UK Stewardship Code 2020…".

[138] See, for example, Discussion Paper DP19/1, at p. 12: "Stewardship has an important role to play in protecting consumers' interests by aligning firms' incentives with the long-term interests of consumers of financial services. Consumers could also benefit from better information about how investors are engaging with issuers to promote their interests. In this regard, encouraging effective stewardship is linked to broader regulatory efforts to ensure that financial services firms' governance, culture and incentives are directed towards promoting consumers' best interests"; and further below: "Public companies in the UK are characterised by a separation of 'ownership', by shareholders who may be widely dispersed, and 'control', which sits largely in the executive and Board. As in other situations where one party (the 'principal') engages another to act on their behalf (the 'agent'), the principal puts in place a set of arrangements for agents to act in the principal's best interests. This is typically done through active dialogue, contractual provisions, disclosure requirements and setting financial incentives". For similar statements at an EU Level see, for example, SRDII, [19].

[139] For an appraisal of the faith put on 'shareholder-value-focused' objective for corporate governance see, *Andrew Keay*, The Corporate Objective, 2011, Ch. 2. See also, *William Bratton*, "The New Economic Theory of the Firm:

The theories bringing up the narrative's theoretical trestle depart from an amalgamation of assumptions about transacting. In a market satisfying the assumptions of convex preferences, perfect competition, demand independence, and costless allocation of resources, an equilibrium of prices reflective of aggregate supplies being equal to aggregate demands for every commodity is reached when further exchange cannot increase one's utility without diminishing another's.[140] Provided there is complete information, transacting in such a market can generate provisions covering all possible future contingencies, making them in principle negotiable to reach allocative-efficient conduct. Transaction costs, however, can be incurred out of market actors' 'guileful self-interest-seeking'.[141] If perfect rationality is assumed in the absence of these costs, efficient monitoring mechanisms can correct potential market failures accruing from the latter.[142] The theories provide a framework for officiating conduct monitoring within firms based on these assumptions. Firms are typically deemed to exist because of their efficient production,[143] largely thanks to an 'entrepreneur's' organisation and exercise of authority mimicking those found in markets satisfying the foregoing assumptions.[144] The entrepreneur is taken to organise and manage the firm accordingly for the purpose of fulfilling his self-interest, and the role is assigned onto him on account of his residual interest, which incentivises him to execute the function as efficiently as possible.[145] In the corporate context, shareholders are typically reckoned to be the firms' entrepreneurs.[146] Accounts like those found in agency theory are usually invoked to explain in turn the role of directors' monitoring by shareholders. Appointed by shareholders to act as their 'agents', firms' efficient productivity is taken to be strongly correlated to the efficient monitoring of directors' control as well as the reduction of the costs accruing from it and directors' shirking from pursuing shareholders' self-interest.[147]

Critical Perspectives From History" Stanford Law Review 41 (1989), 1471; and *Beate Sjåfjell et al.*, Shareholder Primacy: The Main Barrier to Sustainable Companies, in: Beate Sjåfjell/Benjamin J. Richardson (ed.), Company Law and Sustainability: Legal Barriers and Opportunities, 2015.

[140] The use of the theories is done not on moral grounds, but on efficiency grounds. However, arguments were made towards efficiency being a moral ground as well. See, for example, *Richard Posner*, "The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication", Hofstra Law Review 8 (1980), 487.

[141] *David Campbell*, "The Role of Monitoring and Morality in Company Law: A Criticism of the Direction of Present Regulation" Australian Journal of Corporate Law 7 (1997), 343, 349, citing *Oliver E. Williamson*, Markets and Hierarchies, 1975, p. 26.

[142] See on this point as well as the development of arguments about the means the law should be regulated accordingly, Frank H. Easterbrook, Daniel R. Fischel, *The Economic Structure of Corporate Law* (HUP, 1991).

[143] This is in large thanks to relying on Coase's conception about the existence of firms, see *Ronald H. Coase*, "The Nature of the Firm", Economica 4 (1937), 386, 388-392.

[144] *Armen A. Alchian/Harold Demsetz,* "Production, information costs, and economic organization", American Economic Review 62 (1972), 777, 778-781.

[145] *ibid*, 783.

[146] The use of this perspective gave rise to claims, mostly by American scholars, that companies should be run in the interests of shareholders by reference to shareholder value creation. See, for example, *Frank Easterbrook/Derek Fischel*, "The Corporate Contract", Columbia Law Review 89 (1989), 1416; *Frank Easterbrook/Derek Fischel,* "Voting in Corporate Law", Journal of Law and Economics 26 (1983), 395. This tends to be equated to the so-called 'Friedman Doctrine'. But see, *Brian R. Cheffins*, "Stop Blaming Milton Friedman!", Washington University Law Review 98 (2021) 98(6), 1607.

[147] *Michael Jensen/William Meckling*,"Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure", Journal of Financial Economics 3 (1976), 305, 308- 311, 317. But note *Brian R. Cheffins*, What Jensen and Meckling

For it to be efficient, shareholders' monitoring of directors' control requires, inter alia, an ability to measure efficiently the satisfaction of their residual claim.[148] Though no references are made to it by policymakers, the Efficient Capital Market Hypothesis ('ECMH') is typically cited to assume such efficiency or raise the need to achieving proximity to it for making shareholders' monitoring fulfilling its function.[149] A capital market is thought under ECMH it can be allocative efficient when securities' market prices fully reflect the rational assessment of all publicly-available information about their future returns and risks, or at least reflect information to the point where the benefits accruing from acting on it to trade will not exceed the costs of doing so.[150] If the market proves to be thusly efficient, it follows accepting market actors quickly, efficiently and accurately encapsulate information in their valuations and process of transacting.[151] If so, securities' prices and estimates made about and around them will most likely underscore the incorporation of estimates for, inter alia, issuers' future profitability, quality of governance arrangements, the risks inherent in the issuers' business and the likely costs arising from potential exposure to systematic risks (for example, a climate catastrophe).[152] Hence, price movements due to trading and estimates made upon them can be good metrics for calibrating prudent investment and governance strategies, and a lever for enforcing them. If prices and estimates are reflective of issues inherent in corporate governance, issuers can self-regulate themselves to better govern themselves, or give an impetus to securityholders to monitor issuers' behaviour accordingly.[153]

4. The Normative Imperative and Corporate Sustainability

With engagement practices in the limelight more than ever before, accompanied by intentions to see them being instrumentalised for seconding sustainable business, the identification of the 'as and when' of such engagement practices as a matter of law should have been clear. However, as submitted, the law does not seem to project credibly that institutional shareholders should have sustainable business and corporate sustainability in mind when engaging or monitoring engagement.

Really Said About the Public Company, in: Elizabeth Pollman/Robert Thompson (ed.), Research Handbook on Corporate Purpose and Personhood, 2021.

[148] See on this, *Eugene Fama/Michael Jensen*, "Organisational Forms and Investment Decisions", Journal of Financial Economics 14 (1985), 101. Note must be made that although the theories when used in the corporate context are centred around monitoring by shareholders, much of the discussion about managerial accountability produced rather mixed accounts about the role of shareholders in corporate governance on efficiency grounds. For a review of the literature, see *Dionysia Katelouzou*, "The Rhetoric of Activist Shareholder Stewards" New York University Journal of Law and Business 18 (2022), 665. For a critique of the outlook, see *John E. Parkinson*, Corporate Power and Responsibility: Issues in the Theory of Company Law, 1993, Ch. 2 and 10-13.

[149] *Eugene Fama*, "Efficient Capital Markets: A Review of the Theory and Empirical Work", Journal of Finance 25 (1970), 383. For an overview of the theory, see *Ronald J. Gilson/Reinier H. Kraakman*, "The Mechanisms of Market Efficiency" Virginia Law Review 70 (1984), 549.

[150] A capital market in this sense is thought to be 'informationally' efficient, *Michael C. Jensen*, "Some Anomalous Evidence Regarding Market Efficiency" Journal of Financial Economics 6 (1978) 95, 95-96.

[151] *Gilson/Kraakman* (fn. 149), 560-61.

[152] See on this, *Easterbrook/Fischel*, The Economic Structure of Corporate Law (fn. 142).

[153] See on this, generally, *Reinier Kraakman et al.*, The Anatomy of Corporate Law, 3rd ed., 2017, Ch. 2 and 9,

4.1. Duties and Other Responsibilities

Overall, institutional shareholders' duties and responsibilities examined neither recite the contours of engagement practices, nor they outline their frequent adoption or reciprocation with the implementation of an investment strategy integrating ESG considerations and supporting corporate sustainability.[154] Notwithstanding, the Law Commission's review of the law and statements by other regulators imply the duties' and responsibilities' permissibility of such engagement practices.[155] In the case of trust-based pension funds, any such engagement practice can take place in furtherance to the purpose of the trust for the best interests of their beneficiaries per the SIP and the trust deed.[156] FCA regulatees can also adopt these engagement practices provided they comply with the terms and purposes of the investment activity contained in the mandate received while upholding the principles applicable on them.[157] Institutional shareholders must also believe in the compatibility of their approach to shareholder engagement and its monitoring with their duties and responsibilities, for their views will most likely identify whether the approach taken is appropriate.[158]

The purpose of investing activity is typically equated to generating returns and other benefits for clients and beneficiaries within manageable levels of risk assumed over a timeframe appropriate for satisfying their interests, subject to any non-financial interests expressed.[159] Active engagement practices can be an element of an investment strategy instrumentalised in attainment of this purpose. If engagement practices are required to better manage investments for the said purpose, it may be deemed necessary for them to take place. The clarification given about the permissibility and the need for ESG considerations to be factored when they are financially material or when found in alignment with clients' and beneficiaries' non-financial interests makes it safe to assume that periodic engagement practices animated by them are equally permissible, subject to the aforementioned conditions.[160] Any engagement practices promotive of corporate sustainability

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[154] *Johnston/Belinga et al.* (fn. 10), 52.

[155] See, for example, Law Commission, "Fiduciary Duties of Investment Intermediaries" (fn. 35), at p. 107: "That said, it is clearly in the interests of pension funds as a whole to do all they can to promote the long-term success of the companies in which they invest. We think that trustees should be encouraged to consider whether and how to engage with companies to promote their long-term success, either directly or through their investment managers"; and Law Commission, "Pension Funds and Social Investment" (fn. 35) at p. 53: 'Stewardship remains an important tool for pension schemes, especially in the context of socially responsible investment…'.

[156] But see, *Johnston/ Morrow* (fn. 72).

[157] PRIN, Rule 2.1.1R; COBS, Rule 2.1.1R.

[158] *Tom Gosling/Iain MacNeil*, "Can investors save the planet? NZAMI and Fiduciary Duty" Capital Markets Law Journal, 2023, 1, 1-3.

[159] See, for example, Law Commission, "Fiduciary Duties of Investment Intermediaries" (fn. 35), at p. 128: "Our view is that the scope of beneficiaries' best interests depends on the purpose of the trust. Where the purpose of a trust is to provide a pension, trustees will generally act in their beneficiaries' best interests by exercising their investment power to generate the best realistic return over the long term, given the need to control for risks".

[160] See, for example, Pensions Regulator, "DC Investment Governance" (fn. 39): "As climate change is a systemic, macro-economic risk, you should also consider how engagement could be used to mitigate these risks by engaging with investee companies, policymakers and collaborative industry initiatives… Once you have considered the longer-term sustainability of your scheme's investments, you may need to take action to ensure that your policies are being applied; possibly including active public policy engagement, collaborative initiatives and advocacy. This might include

then can be supposed to be equally compatible with institutional shareholders' duties and responsibilities.[161] If no provision about shareholder engagement is given or if the financial materiality of the ESG considerations bringing it up is contested, any engagement practice promotive of corporate sustainability adopted can still prove compatible with institutional shareholders' duties and responsibilities when no risk of significant financial detriment is objectively deemed to accrue.

The permissibility of engagement practices promotive of corporate sustainability, however, must not be overstated. The purpose of investing activity marks the ultimate objective of any engagement practice in the first place, making engagement practices of the latter fashion subject to it. Institutional shareholders' duties and responsibilities afford them with substantial discretion over when, whether and how shareholder engagement or the monitoring of its delegation should be conducted and the causes furthered through them. Upholding the purpose of investing activity for the best interests of clients and beneficiaries can translate to engagement practices promulgating corporate sustainability.[162] Several reasons can justify their action. Such engagement practice can, for example, increase returns for clients and beneficiaries, or prove useful in better managing risk concomitant with the financial performance of a specific investee company or returns potentially to be accumulated by the whole of the investments made.[163] But at the same time, the discretion afforded can equally preserve institutional shareholders' current standard of engagement practices.

Institutional shareholders' incentives to adopt engagement practices of the former type will be the prime element framing the said discretion.[164] Several of the factors affecting engagement practices' standard mentioned in Section 2 can dilute them. Engagement practices supportive of corporate sustainability will most likely require company-specific oversight pertaining to relevant ESG

making changes to the investments included in the default arrangement or those offered to members to select, or engaging with the companies in which investments are held (either directly or via your investment manager or bundled service provider as appropriate)".

161 See statements validating this in DWP Consultation Outcome, at para 48: "Stewardship priorities of investors across the market have evolved in recent years and may keep on doing so. Examples of stewardship priorities include climate change, biodiversity, board remuneration and modern slavery. Trustees will be influenced by risk/return outcomes for members and beneficiaries and may focus on different stewardship priorities to the ones listed in this Guidance. Stewardship priorities may need to reflect the extent of exposure and particular challenges of specific sectors and asset classes in which the scheme is invested".

162 Although see *Dionysia Katelouzou*, Something Old, Something New: Cultivating Institutional Investor Engagement through Shareholder Stewardship, in: Luca Enriques, Giovanni Strampelli (ed.), Board-Shareholder Dialogue: Policy Debate, Legal Constraints and Best Practices, forthcoming, https://ssrn.com/abstract=4283004 accessed 12 April 2023.

163 See on this *Jeffrey N. Gordon*, "Systemic Stewardship" Journal of Corporate Law 47 (2021), 627.

164 The case for the correct incentives being in place are usually deemed to be found in those institutional shareholders typically labelled as 'universal investors', see *James P. Hawley/Andrew T. Williams*, "Universal Owners: Challenges and Opportunities", Corporate Governance: An International Review 15 (2007), 415. Cf. *Benjamin J. Richardson/Maziar Peihani*, "Universal Investors and Socially Responsible Finance: A Critique of a Premature Theory", Banking & Finance Law Review 30 (2015), 405; and *Andrew Johnston*, From Universal Owners to Hedge Funds and Indexers: Will Stewardship Drive Long-Termism and Sustainability?, in: Iris H-Y Chiu/Hans Christoph Hirt (ed.), Investment Management, Stewardship and Sustainability: Transformation and Challenges in Law and Regulation, 2023.

considerations.[165] At present, the fine-grained information required for this and the faculties to gather the information, analyse it and use it to inform institutional shareholders are either unavailable, or lead to inconclusive accounts on the effect of the said ESG considerations on companies and the profitability accruing from shareholding.[166] The capacity to adopt any such engagement practices is additionally dependent on the scale of resources dedicated to them. Currently, evidence shows that engagement teams are small and underfunded.[167] Coupled with business models characterised predominantly by a lack of focus on firm-specific monitoring,[168] these teams appear ill-equipped to carry out specific checks on investee companies, making inevitable the use of pre-determined voting policies and advice by proxy advisors, the accuracy of whose analyses over issues about corporate sustainability is currently debatable.[169] One should not forget the cost of engagement practices as well. With corporate sustainability requiring the assessment of an ever-expanding array of ESG considerations intertwined in a hyper-complex manner, extensive time and resources are in need to be dedicated for shareholder engagement or its monitoring.[170] But in a market characterised by intense competition for attracting clients and beneficiaries, the incentive to incur the costs associated with these can diminish, especially if periodic performance indicators employed assess performance on a relatively short-scale timeframe.[171] Collective action may be an antidote to the latter, but institutional shareholders' accumulation of benefits from it may ultimately be small, disincentivising the likelihood of it occurring. Potency for free-riding behaviour can also be exceptionally high, and competition may flatten the potential of it transpiring.[172]

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165 Regulation aiming at corporates is aimed at generating the said information. Listed companies must now make comply or explain disclosures in their annual reports in relation to the recommendations made by the TCFD and recommended disclosures, see FCA Listing Rules, Rule 9.8.6R(8) and 14.3.27R. The Companies Act 2006 was additionally amended to introduce regulation about the contents of the strategic report that is relevant to sustainability and other issues related to corporate sustainability. See The Companies (Miscellaneous Reporting) Regulations 2018 (S.I. 2018/860); The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 (S.I. 2022/31); and the Companies Act 2006, ss. 414A-414D (as amended).

166 Reports indicate this to be an issue: See, for example, PwC, "PwC's European Investor Survey: The Economic Realities of ESG" (2021), 4-5; and PwC, "UK Investor Survey: The Economic Realities of ESG" (2021), 4-5. For academic opinion on the matter see, *John Armour/Luca Enriques/Thom Wetzer*. "Mandatory Corporate Climate Disclosures: Now, But How?" Columbia Business Law Review 2021 (2022), 1087.

167 See on this, *Julian Franks*, "Institutional Ownership and Governance", Oxford Review of Economic Policy 36 (2020), 258.

168 Usually, those institutional shareholders adopting a passive investment strategy are noted for adopting this model. But see *Dorothy S. Lund/Adriana Robertson*, "Giant Asset Managers, the Big Three, and Index Investing", 2023, https://ssrn.com/abstract=4406204 accessed 20 April 2023.

169 See on the first point, by reference to index funds, *Hirst/Bebchu* (fn. 22), 2077–2082. On the quality of proxy advice see, *Wolf-Georg Ringe*, "Stewardship and Shareholder Engagement in Germany", European Business Organisation Law Review 22 (2021), 87.

170 *Gaia Balp/Giovanni Strampelli*, "Institutional Investor ESG Engagement: The European Experience", European Business Organization Law Review 23 (2022), 869, 886. Intermediation may pose a challenge herein as well. See on this point, *Eva Micheler*, "Facilitating Investor Engagement and Stewardship", European Business Organization Law Review 14 (2013), 29.

171 The arguments stand more on account of some institutional shareholders holding a passive investment strategy. See, for example, *Kahan/Rock* (fn. 22), 1794–1797 (arguing that impact on fees charged as a result of engagement may disincentivise its undertaking).

172 Cf *Condon*, (fn. 25).

Challenging legally institutional shareholders' standard of engagement practices on the ground of it being in breach of their duties and responsibilities because of its failure to be promotive of corporate sustainability can prove a herculean venture. Litigation over shareholder engagement and its monitoring is, virtually, unheard of. Even if, hypothetically, there is one, liability will most likely not be imposed unless there is evidence of conflict of interest or an out-of-all-proportion irrational behaviour on institutional shareholders' part.[173] Further restrictions are found in the ability to bring up a challenge. In case there is a breach of some principles applicable on FCA-regulated institutional shareholders, for example, the FCA has the discretion to enforce them through fines and other enforcement mechanisms.[174] Nonetheless, other individuals are restricted in their ability to bring an action.[175] In addition to collective action problems faced by clients and beneficiaries, litigation may be long and drawn out, and the costs can exceed any benefits obtainable.[176]

Challenging institutional shareholders' standard of engagement practices additionally requires a detailed examination of their operations and a demonstration of more positive results on servicing the purpose of the investing activity for the best interests of clients and beneficiaries if a different approach would be followed. Finding evidence confirming this for it to be then assessed against the judgment of institutional shareholders can prove elusive. Institutional shareholders can at all times defend their decision-making by presenting there is some form of a benefit, whether financial or non-financial, conferrable on clients and beneficiaries through it, or its input in the optimisation of investment management.[177] Courts and regulators will most likely be reluctant to second-guess their decision-making, since the assessment of it will be counteracted by institutional shareholders' good faith belief in the actions' judiciousness.[178] Provided there is good faith action, courts and regulators will most likely not discriminate between any standard of engagement consistent with or being indifferent to one leading to periodic engagement promotive of corporate sustainability.

Finding evidence to the contrary seems, at present, difficult. Any engagement practice made to push for corporate sustainability may spring some form of a benefit to clients and beneficiaries,

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[173] See, by reference to engagement dedicated to climate-change-related considerations *Gosling/McNeil* (fn. 158), 15-16. See also, by reference to enforcing shareholders' duties, *Dionysia Katelouzou/Konstantinos Sergakis*, Shareholder Stewardship Enforcement, in: Dionysia Katelouzou/Dan Puchniak (ed.), Global Shareholder Stewardship, 2022; *Iris H-Y Chiu*, Private vs Public Enforcement of Shareholder Duties, in: Hanne S. Birkmose/Konstantinos Sergakis (ed.), Enforcing Shareholders' Duties, 2019. Note must be made that there has been a case involving the practices of pension funds and their divestment in securities and ventures contributory to climate change. See *McGaughey and another v Universities Superannuation Scheme Ltd and another* [2022] EWHC 1233 (Ch) (High Court). As of the time of writing, the case will be subject to appeal. For a commentary on this, see *Ewan McGaughey*, "Holding USS Directors Accountable, and the Start of the End for Foss v Harbottle?", Oxford Business Law Blog, July 2022, https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/07/holding-uss-directors-accountable-and-start-end-foss-v-harbottle accessed April 2023.

[174] Financial Services and Markets Act 2000, s.138D.

[175] A private person who has suffered loss as a result of a breach of COBS Rule 2.1.1R may bring an action for breach of statutory duty under section 138D of Financial Services and Markets Act 2000. In its 2014 Review, the Law Commission did not find any claims that have been successfully brought under COBS 2.1.1. However, a private person cannot bring an action for the breach of PRIN, Rule 3.4.4R.

[176] *Johnston/Belinga et al.* (fn. 10), 55-56.

[177] *Gosling/McNeil* (fn. 158), 15-16.

[178] In many ways the lack of second-guessing may derive from court's overall reluctance to adjudicate business decisions in hindsight. See on this point, *Parkinson* (fn. 148), Ch. 9-11.

either immediately or in the long-term. Institutional shareholders are often found to be more suited to adopt engagement practices over those issues because their beneficiaries' and clients' interests are assumed to be aligned with a timeframe leading to the enjoyment of benefits potentially accruing from them.[179] Yet identifying the compatibility of the said timeframe with the interests of clients and beneficiaries for the purpose of countering it against decision-making going contrary to it is not always obvious. Clients and beneficiaries may or may not be open to factoring ESG considerations in investment management and engagement practices.[180] Clients and beneficiaries may also have different time sensitivities over their financial interests and hence the financial materiality of ESG considerations accruing from specific investee companies or different non-financial interests, muddying the exact determination of whether engagement practices promotive of corporate sustainability are ultimately in their best interests.[181]

Finding financial materiality of frequent engagement practices broached with ESG considerations can also prove difficult. Despite the evidence showing the detrimental environmental, social and economic impact of the current state of business and human activity generally,[182] there is not enough credible data to assess the prudence of a business decision taking action against the risks accruing from neglecting them, or the effect of the failure to integrate ESG considerations in particular business decisions, the exposition to them in the future, or the corresponding effect they may have on investments and returns to clients and beneficiaries.[183] Present reporting neither provides credible assessments of risk geo-spatially and inter-temporally, let alone displaying their application on specific assets or business conducted by investee companies; nor differentiates between losses arising from exposure to them or liabilities stemming from failure to account for them.[184] The regulation for sustainable finance means to make information available in resolution to the issue. Yet several models employed currently by businesses and investors to manage and assess risk either do not reflect accurately on the impacts flowing from failing to address ESG considerations, or their implementation may produce conflicting results.[185] Misalignment of incentives and incoherent assessments over addressing ESG considerations in business and investing may further flatten the efforts to assess their likely impact.[186] Even if evidence would have been credible and available, the use of it to measure institutional shareholders' stance on engagement and its monitoring will most likely remain unclear, since there will still be need to square it along establishing causality between institutional shareholders' dealing with them, its

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[179] See for examples statements to this end in Walker Review, p. 69 -71. Usually, this is identified with the interests of clients and beneficiaries being classed as long-term in nature. See, inter alia, Discussion Paper DP19/1, p. 12; SRDII, [19], Commission Impact Assessment, p. 18-21.

[180] *Davies*, The UK Stewardship Code (fn. 103), p. 61.

[181] *Zetzsche/Anker-Sørensen*, "Regulating Sustainable Finance in the Dark" (fn. 59), 65.

[182] See for example, from the perspective of climate change, Intergovernmental Panel on Climate Change, Climate Change 2021: The Physical Science Basis: Summary for Policymakers, in: Valerie Masson-Delmotte et al. (ed.), Climate Change 2021: The Physical Science Basis. Contribution of Working Group I to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change, 2021; *Veronika Eyring et al.*, Human Influence on the Climate System, in: Valerie Masson-Delmotte et al. (ed.), Climate Change 2021: The Physical Science Basis. Contribution of Working Group I to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change, 2021.

[183] *Madison Condon*, "Market Myopia's Climate Bubble", Utah Law Review 2022, 63, 79-80.

[184] *ibid.* For design solutions to this issue as a matter for regulation see, this *Armour/Enriques et al.* (fn. 166).

[185] *ibid*, 80-84.

[186] *ibid.* The argument poised is hardly new. See *William W. Bratton/Michael L. Watcher*, "The Case Against Shareholder Empowerment", University of Pennsylvania Law Review 158 (2010), 653.

effect on investee companies' governance, and the interests of institutional shareholders' clients and beneficiaries.[187]

The trust deed and mandates received from clients and beneficiaries can possibly give impetus to adopting engagement practices promotive of corporate sustainability. Evidence available is not telling of any explicit statements about them.[188] Regardless, a proximate standard for them can be inferred from mandates, trust deeds, and other disclosures made as being consistent with the stated purpose of investing activity.[189] The regulation for shareholder stewardship and sustainable finance purport to provide transparency over using shareholder engagement and its monitoring for such purposes, encouraging the market for stewardship to transpire and enforce the said standard.

But whether the disclosures made in congruence with the investment mandates received will be reflective of a desire for engagement practices to be pro-corporate sustainability and a reciprocal materialisation of the said desire through actions taken in practice is anyone's guess.[190] Relying on the market for stewardship to enforce a specific attitude for shareholder engagement and its monitoring implies there is demand for them, either because it constants with financial benefits, or because it is associated with advancing other non-financial causes clients and beneficiaries deem important.[191] To the author's knowledge, no cogent empirical studies exist about whether any such engagement practices can increase returns or benefits for clients and beneficiaries. Empirical studies analysing the impact of ESG integration on profitability in different settings can prove good substitutes. Nonetheless, the mixed results produced at present cannot substantiate any claims for the financial veracity of engagement practices informed by ESG considerations.[192] Demand for shareholder engagement and monitoring which integrates ESG considerations and supports corporate sustainability by clients and beneficiaries may potentially grow in the future due to regulation and the investment preferences of younger generations investing in the market.[193] But at present, regulation on business and sustainable development is at its infancy, and the market

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[187] *Gosling/McNeil* (fn. 158), 15-16.

[188] *Johnston/Belinga et al.* (fn. 10), 54, citing BIS, "Metrics and Models Used to Assess Company and Investment Performance" (October 2014) BIS Research Paper No.190, p. 19. See also PwC, "UK Investor Survey" (fn. 166); and Investment Association, "Stewardship in Practice: IA Stewardship Survey" (November 2018).

[189] A number of reports and guidelines suggest this as part of developing policies and guidelines on the matter. See, Investment Association, "Good Stewardship Guide 2021" (February 2021); Investment Association, "The Model Discretionary Investment Management Agreement" (November 2021); Impact Investing Institute, "Impact Investing for Pension Funds: Fiduciary Duty—The Legal Context" (October 2020).

[190] Compare, for example, *Alessio M. Pacces*, "Will the EU Taxonomy Regulation Foster Sustainable Corporate Governance?", Sustainability 13 (2021), 1 (arguing for the theoretical plausibility of the regulation adopted to give the information required to ignite a market for stewardship permeated by sustainability-minded clients and beneficiaries, prompting thusly institutional shareholders to increase their engagement frequency to become a primary means of aligning better with what could be considered as 'sustainable investing' to attract clients and beneficiaries, and drive demand for it); and *Dorothy S. Lund*, "Asset Managers as Regulators", University of Pennsylvania Law Review 171 (2022), 77 (arguing that costs in adopting those engagement tactics can be excessive, and profit-minded institutional shareholders – seen from the perspective of asset managers – will be disincentivised to step into the role of 'frequent engagement actor').

[191] *Dionysia Katelouzou/Eva Micheler*, The Market for Stewardship and the Role of the Government, in: Dionysia Katelouzou/Dan Puchniak (ed.), Global Shareholder Stewardship, 2022, p. 76-83.

[192] *Sanjai Bhagat*, "An Inconvenient Truth About ESG Investing", Harvard Business Review (2022), https://hbr.org/2022/03/an-inconvenient-truth-about-esg-investing accessed 19 April 2023.

[193] *Ringe* (fn. 2), citing Deloitte, "The Deloitte Global Millennial Survey 2020" (2020), 9.

share of younger individuals remains still small to effectuate changes in capital markets' structures and attitudes to accommodate their predilections.

Moreover, issues over business and sustainable development are still subjected to multifaceted, and admittedly divisive, interpretations, especially when profitability is used as the yardstick for measuring their significance. Institutional shareholders adopting engagement practices to support corporate sustainability may face backlash for doing so as much as it is quite possible for backlash to be received for the lack thereof.[194] Key institutional shareholders have taken the stance of raising awareness over the importance of engagement practices catering to the unsustainability of certain business sectors, often by claiming the financial sense underscoring it.[195] But as benevolent as it may seem, there is conflicting evidence on the erudition of the claims made.[196] Indicative statements made from some institutional shareholders are also criticised for being nothing more than 'virtue signalling' on account of their investment actions, questioning hence their motives.[197] Even if backlash would not prove an apposite issue, detecting the exact penchants of clients and beneficiaries over corporate governance and sustainability and translate them ex ante into actionable engagement policies that will be disclosed back to clients and beneficiaries for them to police them accordingly is an arduous task for institutional shareholders to commit themselves to. Capacity to engage with investee companies or monitor the delegation of it per the preferences expressed will vary, and so will be the capacity to predict the ability to do so in pursuit of specific objectives for them to be disclosed in a policy for its dealing and implementation.[198]

Delegation of shareholder engagement to asset managers can mitigate possible disparities in engaging or alleviating the effect of any barriers to active engagement. Yet again, capital markets' structures and investment intermediation can negate the linking of shareholder engagement with mainstreaming more sustainable business. Furthermore, asset managers may receive conflicting instructions from clients about shareholder engagement, and they may or may not cite the same concerns. On account of the manner contracts for asset management are awarded and rewarded by hitting key performance indicators, asset managers may continue implementing a 'lowest common denominator' approach attached to 'bottom line' impact of shareholder engagement, even if their approach to it will trickle down to passivity or engagement indifferent to issues

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194 *Tom Giles Kelly*, "Institutional investors as environmental activists" Journal of Corporate Law Studies 21 (2021), 467, 486.

195 See, for example, *Larry Fink*, "A sense of Purpose" (Blackrock, 2018) https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter; accessed 19 April 2023; *Larry Fink*, "Larry Fink's 2022 Letter To CEOs: The Power of Capitalism" (Blackrock, 2022) https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter accessed 19 April 2023.

196 See for example, ShareAction, "Voting Matters 2021: Are Asset Managers Using their Proxy Votes for Action on Environmental and Social issues?" (December 2021), p. 22 (showcasing that major institutional shareholders had a tendency to vote more conservatively than recommended by major proxy advisory firms).

197 See, for example, *Tariq Fancy*, "The Secret Diary of a 'Sustainable Investor" (Medium, 2021) https://medium.com/@sosofancy/the-secret-diary-of-a-sustainable-investor-part-1-70b6987fa139 accessed 19 April 2023. Cf *Alex Edmans*, "Is Sustainable Investing Really a Dangerous Placebo?" (Oxford Business Law Blog, 2021) https://www.law.ox.ac.uk/business-law-blog/blog/2021/11/sustainable-investing-really-dangerous-placebo accessed 19 April 2023.

198 The issue was much prevalent from the early versions of the Stewardship Code, see *Davies*, The UK Stewardship Code (fn. 103), p. 50-57.

surrounding corporate sustainability.[199] Collective action problems may continue to be prevalent too. In the event a consensus among clients is possible to be reached, asset managers may still have to work together with fellow shareholders, requiring possibly each and every one of them to accumulate some benefit to hit their own performance indices or overcome their respective internal challenges to undertake any form of engagement.[200]

4.2. The Expectations Arising from the Regulation for Shareholder Stewardship

Owing to the room institutional shareholders' duties and responsibilities discussed above confer for them to take place without much compulsion for their occurrence, the only sign symbolic of the law advising institutional shareholders should adopt engagement practices propounding of corporate sustainability resides with the application of the regulation for shareholder stewardship in discharge of the expectations regulators endeavour to impose onto institutional shareholders through it.[201] The expectations' enforcement and meeting presupposes the provisional working of the market for stewardship correspondingly.[202] However, as already elaborated above, several hurdles can trample the market for stewardship's functioning to demand specific actions to be apparent, and the same can arguably apply for enforcing the expectations in question.

But in supposition the overcoming of these hurdles is feasible, it is possible to see some scope in the application of the regulation for shareholder stewardship in discharge and in enforcement of these expectations for forming impliedly an imperative essentialising engagement practices to be promotive of corporate sustainability.[203] Granted, corporate sustainability is clearly not the end of shareholder engagement or its monitoring attempted to be ascribed. Once institutional shareholders decide it is best for engagement practices to be actively present, institutional shareholders are envisaged to conform with shareholder stewardship's ideal for them subject to their duties and responsibilities.[204] And as noted, shareholder stewardship's ideal endeavours to galvanise the furtherance of the interests of institutional shareholders' clients and beneficiaries by supporting prudent corporate governance guided by the creation of shareholder value and estimates made about it following the appreciation of all considerations that can affect it. References to creating 'sustainable benefits' or 'long-term value' are not intended to direct institutional shareholders' attention away from clients' and beneficiaries' financial interests or the creation of shareholder value.[205] Pursuing clients' and beneficiaries' financial interests by having

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[199] Law Commission, "Fiduciary Duties of Investment Intermediaries" (fn. 35), p. 101-107.

[200] See on this, *Tim Bowley/Jennifer G. Hill*, Stewardship and Collective Action: The Australian Experience, in: Dionysia Katelouzou/Dan Puchniak (ed.), Global Shareholder Stewardship: Complexities, Challenges, and Possibilities, 2022.

[201] See on this, *Kelly*, (fn. 194).

[202] But see *Katelouzou/Micheler* (fn. 191). Cf, *Tim Bowley/Jennifer G. Hill*, "The Global ESG Stewardship Ecosystem", European Corporate Governance Institute - Law Working Paper No. 660/2022, 2022, https://ssrn.com/abstract=4240129 accessed 19 April 2023.

[203] Cf *Beate Sjåfjell*, Achieving Corporate Sustainability: What is the Role of the Shareholder?, in: Hanne S. Birkmose (ed.), Shareholders' Duties in Europe, 2017.

[204] See discussion made in Section 3.2.2, above.

[205] See for example, Feedback Statement FS19/7, at p. 12-13: "A focus on clients' and beneficiaries' interests provides a more consistent basis for regulation. As a regulator, we want to ensure that firms carry out stewardship effectively where this is integral to delivering good value for their customers. However, this should not prevent an asset owner

indices anchored on shareholder-value-creation metrics remains the main overriding qualification policymakers propound to dictate the percipience of any engagement practices adopted.[206]

Nonetheless, the expectations do intend to invoke a change in the pursuit of the presumed profit-seeking goal.[207] The expectations, in addition to supporting good governance, point to shareholder engagement and the monitoring of its delegation being troubled with ESG considerations arising from investee companies' business as if they should be regarded as material to furthering clients' and beneficiaries' financial interests and the creation of shareholder value.[208] Whereas the pursuit of returns for clients and beneficiaries guided by shareholder-value creation seems to be the ultimate objective poised for institutional shareholders to meet, the process in which they are awaited to do so is invited to be morphed by ESG considerations and companies' resilience and longevity in the hope of satisfying the interests of institutional shareholders' clients and beneficiaries while being mindful of all parameters ulteriorly affecting them now and in the long-term.[209] The centrality of ESG considerations and companies' longevity in the expectations seems to be planned to be reconciled with seeing institutional shareholders adopting engagement practices signalling corporate governance permeated by them whenever it is in overall beneficial for their clients and beneficiaries on account of the value created and the corresponding returns generated for them over time.

The scope provided to see this form of shareholder engagement and respective monitoring can prove for one quite appealing. In part, the appeal may stem from the current work done to regularise the input of business to sustainable development. As calls for realising sustainable development grow in number, the integration of ESG considerations in decision-making and corporate sustainability are gradually legitimised through them being framed as material for living up to the present perception of business responsibility wedded to the ethos of the shareholder-value-driven, aggregate/contractarian outlook of companies led by creating corresponding returns to end investors.[210] This 'financialised' model of legitimising the integration of ESG considerations and corporate sustainability invites business and investment decision-making to espouse both on the grounds of better measuring and managing risks and returns.[211] It furthermore posits the incidental accruement of wider benefits for the society, since capital and resources are thought they can be allocated in ventures tasked to realising sustainable development in an allocative

from promoting a wider purpose in its investment beliefs and in the investment mandates it sets for its asset managers, if it considers that this would be consistent with beneficiaries' preferences".

206 *ibid* at p. 14: "In line with much of the feedback, we consider that for many firms stewardship will be an integral part of their strategy to deliver long- term sustainable value creation, in the best interests of their clients and beneficiaries. The focus of stewardship will then be determined by this long-term objective. It will therefore typically include careful consideration of ESG factors, consistent with the UK Stewardship Code 2020…".

207 Prominent economists make an argument similar to this one. See, for example, *Oliver Hart/Luigi Zingales*, "The New Corporate Goverance", University of Chicago Business Law Review, 2022, 195.

208 Feedback Statement FS19/7, p. 12-14; Green Finance Strategy, p. 55-60. The EU made several remarks to this end as well. See, for example, SRDII, [9]; and European Commission, "Action Plan: Financing Sustainable Growth" (fn. 40).

209 *ibid.*

210 *Iris H-Y Chiu/Lin Lin/David Rouch*, "Law and Regulation for Sustainable Finance" European Business Organisation Law Review 23 (2022), 1, 4.

211 For the reasons of its possible espousal, see, *McNeil/Esser* (fn. 60), 20-29. See also on this, in general, *Stefanie Hiss*, "The Politics of the Financialisation of Sustainability" Competition & Change 17 (2013), 234.

efficient manner, transforming the supply of capital and mechanisms structured around it into key drivers for it.[212]

Perhaps more importantly, though, the appeal of it may originate from policymakers' concomitant faith in decision-making signalled by the quest to create shareholder value and estimates made about it to support obliquely investee companies' longevity and social welfare, including the servicing of the interests of institutional shareholders' clients and beneficiaries and the facilitation of corporate sustainability. If such faith corroborates, any action adopted should by nature indorse obliquely the foregoing; for they should be either reflected in the creation of shareholder value or being reflective of creating shareholder value, making their addressment imminent to create it.[213] The corroboration of it connotes the estimates made over shareholder value creation, both in terms of measuring future returns and the pricing of shares in capital markets in view of all risks arising from holding them and/or trading with them, are accurate and informed of all things relevant to companies' business, the outlook of them becoming more environmentally, socially and economically sustainable, and the potential benefits conferrable to clients and beneficiaries from it.[214] If true, they can prove to be reliable metrics for taking any relevant action, and hence shareholder engagement versed primarily by them can similarly endorse more sustainable business.

The potential limitations in validating the empiricism of the faith, however, should raise some serious contentions over the judiciousness of having too much confidence in it, and some scepticism should naturally follow over whether an imperative advising actions to be morphed primarily by shareholder-value creation and estimates made around it can credibly stress a move towards sponsoring corporate sustainability. There are notable findings on market actors' deviation from the assumptions made to base them up, revealing 'boundedly-rational' tendencies or proneness to making frequent cognitive errors when transacting and assessing estimates of value.[215] The issues corporate sustainability and sustainable development call business actors to consider additionally impose tremendous obstacles to create metrics accurately estimating risk and return from holding specific shares in light of them, making any action taken on their strength of accuracy contentious.[216] The effects of climate change, the input of certain businesses to it and its effect on their financial performance exquisitely exemplifies this. Although climate change being anthropogenic and adversely impactful on business is a fact, the level of uncertainty from the scale of the potential harm it can cause, the reflection of it on the performance of businesses and shares' valuations, and the rebound effects of addressing it is extremely deep due to failures in appreciating accurately their reach and in configuring their socio-economic impact over specified times,

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[212] *ibid*, 29-31.

[213] See on this, from the perspective of the SRDII provisions, *Rafael Savva*, "Regulating Institutional Shareholders in the Medium to the Long-term: An Analysis of the 2017 Shareholder Rights Directive's Shareholders' Duties" International Company and Commercial Law Review 14 (2020),1, 3.

[214] *ibid*. This is an argument that is usually aligned with analyses from a shareholder primacy perspective. See, for example, *Henry Hansmann*, The Ownership of the enterprise, 1996, Ch. 1-3.

[215] See, inter alia, *Nicholas Barberis/Richard Thaler*, A survey of Behavioural Finance, in: George M. Konstantinides et al. (ed.) Handbook of the Economics of Finance, Vol 1A, 2003; *Cass R. Sunstein et al.*, Behavioural Approach to Law and Economics' Stanford Law Review 50 (1998), 1471.

[216] See on this, from the perspective of the EU's efforts to introduce regulation for sustainable finance, *Iris H-Y Chiu*, "The EU Sustainable Finance Agenda: Developing Governance for Double Materiality in Sustainability Metrics", European Business Organisation Law Review 23 (2022), 87.

business sectors, or decisions made.[217] Pressure is put on capital markets and business to deal with issues connected to climate change, but there is limited credible information to be used for calibrating their decision-making solely based on estimates of likely risks and returns.[218] Even when there will be such information available, present methods used to arrive at accurate estimations of risks and returns cannot aggregate the risks arising from climate change or from the contribution to it for creating a consensus over the probabilities of loss generated if they are left unaddressed, let alone outline the effect different methods of addressing them have on markets, companies, and investments.[219] Several methods used to quantify risk typically produce estimates of losses in potential scenarios in reliance to information available and sophisticated financial risk modelling.[220] Yet the employment of some of them at present produces results with minimum risk from climate change. The methods are typically used to ascertain the net value of present investments made. Dealing, however, with climate-change-related issues may require incurring tremendous amount of costs upfront, with small, long-term benefits potentially conferrable in the future. When discounted at standard rates based on the current flow of information available, the net value in the estimates made can diminish.[221]

Usually in reliance to ECMH, several legal scholars either dismiss the issue or consider it to be a soluble matter in so far most market and business actors act on pricing shares arrived at as accurately as possible estimates of their long-term value-generating potential (or lack thereof) against all risks and issues capable of affecting it, whose actions can offset possible deviations.[222] Any findings suggesting the contrary are appreciated to be incomplete, citing the need for express demonstrations of deviations from the findings of ECMH.[223] Respectful as it should be, the

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[217] *Jay Cullen/Jukka Mähönen*, "Taming Unsustainable Finance: The Perils of Modern Risk Management" in: Beate Sjåfjell/ Christopher M. Bruner (ed.), Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, 2019, p. 107. On the rebound effects of sustainable development actions, see generally, *Mike Berners-Lee*, There Is No Planet B: A Handbook for the Make or Break Years, 2019, Ch. 2 and 3.

[218] *Jeroen Veldman/Andreas Jansson*, "Planetary Boundaries and Corporate Reporting: The Role of the Conceptual Basis of the Corporation", Accounting, Economics, and Law: A Convivium 10 (2020), 1, 5-7.

[219] *Cullen/Mähönen* (fn. 217), p. 107-108.

[220] One standard measure used to estimate potential losses arising from risk exposure is value at risk (VaR). VaR provides probability estimates about when an expected loss will fall within a certain range. VaR, however, may not have much to say about the potential magnitude of losses arising from scenarios having low probabilities of occurring. Given the uncertainty of risks arising out of exposures to risks occurring from climate change, they may lie in the low-probability zone, which is likely going to be discounted as a risk that is unlikely to transpire. For an id-depth discussion of the issue, see *Condon*, "Market Myopia's Climate Bubble" (fn. 183), 80-84.

[221] *Cullen/Mähönen* (fn. 217), p. 107-108.

[222] The dismissal of the arguments originally derives from dismissals of short-termism being detrimental for corporate governance and societies. See for example, *Roe* (fn. 20); *Lucian A. Bebchuk*, "The Myth that Insulating Boards Serves Long-Term Value" Columbia Law Review 113 (2013), 1637. This argumentation is used as a basis to criticise the rationale behind the introduction of regulation aiming to facilitate corporate sustainability. See, for example, *Mark J. Roe et al*, "The European Commission's Sustainable Corporate Governance Report: A Critique" European Corporate Governance Institute - Law Working Paper 553/2020 (2020), https://ssrn.com/abstract=3711652 accessed 19 April 2023.

[223] See on this, from the perspective of short-termism, *Anderson* (fn. 11). See also *Mark J. Roe/Roy Shapira*, "The Power of the Narrative in Corporate Lawmaking" Harvard Business Law Review 11 (2021), 234 (arguing that short-termism takes the blame for most of the phenomena and malaises of corporate governance, even if they prove empirically contested, and that different methods, such as the imposition of a carbon tax would be a better alternative).

argumentation presented is far from being unproblematic.[224] Empirical evidence on the validity of ECMH is voluminous yet inconclusive in terms of the absolute holding of its truth.[225] ECMH's assertion of efficient capital markets is typically averred on two key grounds: the rapid and consistent incorporation in prices of all publicly available information about securities and their past and future price movements in the market, and the possibility of offsetting biases by market actors who are rational, bringing up in the meantime pricing proximate to the fundamental value of securities.[226] Biases in assessing risk and return following the processing of hyper-complex issues like achieving corporate sustainability and sustainable development can be systematic in nature, however, for they are common across a significant portion of the aggregate of market actors, making them hence difficult to be offset.[227]

Excessive weighting of biases can be argued though to be an opportunity for potential arbitrageurs, correcting hence pricing in so far as price movements following their arbitrage have the effect of indirectly conveying the information used to less or inaccurately informed counterparts for them to adjust their behaviour.[228] Elegant as this argument may be, several structural obstacles to realising it can undermine the possibility of it happening. Especially with regards to ESG considerations, it is not infeasible for arbitrageurs to exhibit the same biases as other market actors.[229] It is furthermore uncertain if acting against prevailing (and potentially irrational) market trends are in themselves rational in the economic sense. if exit for an arbitrageur is a possibility before incoherent valuations are detected, the returns reaped from the sale of an investment made can be more prevalent when assessed against the odds of endeavouring to arbitrage.[230] So long as there is substantial mispricing, a necessary trigger for arbitrage to commence is additionally required in the presence of costs to conduct it. If the costs incurred to better inform oneself are significant enough, the economic viability of arbitrage will arise only when the projected gains are greater than the costs incurred. And in the potential absence of information confirming it, the security must be severely mispriced for an opportunity for arbitrage to manifest.[231]

Having the creation of shareholder value as the guide for adopting any actions on the strength of the accuracy of the estimates made about it in reliance to the holding of the theories employed to suggest it, therefore, can possibly lead to displaying preferences for a lower impact on profitability, even when ultimately they may prove catastrophic for everyone in the long-term, or incapable of

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224 For the persistence of the espousal of ECMH, see, *John Quiggin*, Zombie Economics: How Dead Ideas Still Walk Among us, 2011, pp. 35-78.

225 *Andrei Shleifer*, Inefficient Markets: An Introduction to Behavioral Finance, 2000, p. 5-10, 16-23. The same however, should be noted that it applies for short-termism and the postulation of long-termism as a solution. For an overview, see *Roe/Shapira* (fn. 223), 242-244.

226 See *Gilson/Kraakman* (fn. 149).

227 See on this, from the perspective of discussing short-termism, *Moore/Walker-Arnott* (fn. 11), 420.

228 *ibid*, 421.

229 This can be particularly the case in the absence of metrics for sustainable development and business, or the lack of sagacious data and information capable of being used to this end. See *Chiu*, "The EU Sustainable Finance Agenda" (fn. 219), 95-104.

230 *Moore/Walker-Arnott* (fn. 11), 421-423. For an overview of the limits to arbitrage literature, see, *Lynn A. Stout*, "The Mechanisms of Market Inefficiency: An introduction to the New Finance", Journal of Corporation Law 28 (2003), 635.

231 See on this, generally, Ronald J. Gilson/Reinier Kraakman, "The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias", Journal of Corporation Law 28 (2003), 715, 731-735.

indorsing more sustainable outcomes.[232] On account of the foregoing, capital market and business actors acting solely by reference to estimates of shareholder-value creation or the pursuit of it, are prone to exhibit behaviour not revealing of transitioning towards becoming more environmentally, socially, and economically sustainable or conscious of ESG considerations. This undermines the capacity of the imperative formed by the expectations to realise the essentialising of the adoption of engagement practices promotive of corporate sustainability. Animated solely by shareholder-value creation and estimates made around it, it is hoped that institutional shareholders will adopt engagement practices safeguarding investee companies' good corporate governance and the addressment of any ESG considerations accruing from it following their examination. Yet it is possible they may fail to do so credibly when the creation of shareholder value primarily determines the sagacity of their actions, either because the information needed is unavailable, or because it can lead to speculating on outcomes moderately uncertain.

Regulation can of course cultivate better disclosures of information, assisting in the correction of many of the aforesaid.[233] Yet the fact remains the integration of the information to estimates may still be prone to displaying unreliable probability estimates of risks and returns inherent with issues surrounding corporate sustainability, simply because they will either continue to be rather speculative, or uncertain as to the exact outcomes from businesses' exposure to damage potentially caused by leaving ESG considerations unaddressed.[234] A call for taking action informed solely by the incentive to create shareholder value remains susceptible to advancing a tendency for displaying preferences for actions integrating ESG considerations mainly when they explicitly specify they will create shareholder value.[235] The problem with an imperative channelling institutional shareholders' focus for corporate sustainability based on it is the prompt it establishes for actually adopting these engagement practices mainly when there is substantial evidence shareholder value will be created or diminished over a specified timeframe if such matters are left unaddressed, even when evidence to the contrary for the former may still create catastrophic losses for everyone.[236] Rather than postulating the endorsement of corporate sustainability precautionary

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[232] *Savva*, "Regulating Institutional Shareholders in the Medium to the Long-term" (fn. 213), 10.

[233] This is not a novel argument. Instrumental regulation aiming at facilitating the mechanics of the market to facilitate optimal behavious in the sense of achieving allocative efficiency were traditionally made. See, for example, *Easterbrook/Fischel*, The Economic Structure of Corporate Law (fn. 142). Cf *Andrew Johnston*, "Governing Externalities: The Potential of Reflexive Corporate Social Responsibility", Centre for Business Research, University of Cambridge, Working Paper No. 436, 2012, https://ssrn.com/abstract=2165616 accessed 20 March 2023.

[234] *Andrew Johnston/Beate Sjåfjell*, The EU's Approach to Environmentally Sustainable Business: Can Disclosure Overcome the Failings of Shareholder Primacy?, in: Marjan Peeters/Mariolina Eliantonio (ed), Research Handbook on EU Environmental Law, 2020, p. 404-408.

[235] *Colin Mayer*, Prosperity: Better Business Makes the Better Good, 2018, p. 35-44.

[236] On the merits and demerits of a business case to approaching corporate sustainability see, from the perspective of corporate social responsibility initiatives aiming to facilitate companies' environmental sustainability, *David Millon*, Corporate Social Responsibility and Environmental Sustainability, in: Beate Sjåfjell/Benjamin J. Richardson (ed.), Company Law and Sustainability: Legal Barriers and Opportunities, 2015); and *Christopher M . Bruner*, "Corporate Governance Reform and the Sustainability Imperative", Yale Law Journal 131 (2022), 1217. Similar arguments to this end were displayed by reference to short-termism and institutional shareholders' proneness to them. See *Thomas Lee Hazen*, "The Short-Term/Long-Term Dichotomy and Investment Theory: Implications for Securities Market Regulation and for Corporate Law", North Carolina Law Review 70 (1991), 137; *Iman Anabtawi/Lynn Stout*, "Fiduciary Duties for Activist Shareholders" Stanford Law Review 60 (2008), 1255; *Kent Greenfield*, "The Puzzle of Short-termism", Wake Forest Law Review 46 (2011), 627.

to ensure the feasibility of sustainable development, the expectations cultivate the adoption of engagement practices which may outright fail to consider these issues not for the lack of trying, but for the lack of the provision of normative premises suggesting to be mindful of corporate sustainability and sustainable development regardless of shareholder value creation.

5. Conclusion

The Article examined the main legal regime regulating institutional shareholders' engagement practices following the introduction of the regulation of shareholder stewardship as it interacts and will interact with the regulation for sustainable finance to see whether it credibly dictates engagement practices to promote corporate sustainability. The Article signified the regime's permissibility of these practices once proven to be in alignment with the furtherance of the purpose of investing activity for the best interests of institutional shareholders' clients and beneficiaries, but also the discretion afforded for their undertaking. It furthermore outlined policymakers' and regulators' effort to impose several normative expectations onto institutional shareholders about shareholder engagement and its monitoring once delegated through the application of the regulation for shareholder stewardship, but expressed scepticism over their capacity to advocate for regular engagement practices supportive of corporate sustainability. The scepticism derives from finding limits in the expectations' confidence put on taking action signalled by shareholder-value creation and estimates made about it to uphold obliquely causes like corporate sustainability.

In the author's opinion, facilitating the begetting of corporate sustainability requires its actual advancement based on theoretical and regulatory concepts developed for it. In view of the effect of shareholders' formal power, encouraging institutional shareholders' engagement practices to become a tool for facilitating corporate sustainability should be supported. The arguments posed in this Article are suggestive of the opinion that neither the law currently regulating these nor the conceptual and theoretical underpinnings used to bring it up can adequately help with achieving the former on their own. But one must be careful when making this argument. The theories influencing the theoretical trestle founding shareholder stewardship's narrative put forward suggestions for the use of techniques and methods for corporate governance which can effectively monitor its functioning, and their use over issues concerned with corporate sustainability can prove invaluable for its facilitation across companies when they are permeated by a framework determining their function relative to realising corporate sustainability. A discussion over the contribution of institutional shareholders' engagement practices to facilitating the attainment of corporate sustainability is necessary to be made, but the discussion's theoretical foundation should extend beyond parameters solely set by theories reliant on the contractarian/aggregate outlook of companies to truly gauge the ways the said framework will be developed in attainment of its purpose. To effectuate this, a great deal more work on delineating what institutional shareholders should actually do when engaging relative to the governance and issues at hand that is relevant to corporate sustainability is required to be undertaken. It is hoped that this Article will pave the way to advancing this discussion while being mindful of capital markets' realities.