The Unseen 'Others': A Framework for Investor Stewardship

Law Working Paper N° 793/2024
August 2024

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ECGI Working Paper Series in Law

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Abstract

Institutional investors, acting as stewards, (1) exercise power and influence (2) on behalf of their clients and/or beneficiaries, and in doing so, (3) regard a broader spectrum of 'unseen' others, including end investors, investable assets, and the broader economy, environment, and society. This analytical framework reveals a crucial and often overlooked distinction in investment management: the 'others' on whose behalf investor stewards act (clients/beneficiaries) may not always align with the 'others' for whom they ultimately act. By introducing a heuristic of multiple stewardship relationships within the investment chain client stewardship, end-investor stewardship, asset stewardship, and sustainability stewardshipthis article builds the model of enlightened stewardship and highlights a significant challenge: stewardship relationships beyond client stewardship operate outside the domain of hard law. As a result, the article advocates for stewardship codes to 'crowd in' enlightened stewardship, complementing both national and international regulatory frameworks and leveraging intrinsic motivations that drive responsible investment conduct. Using the UK Stewardship Code as a case in point, the article points to the current boundaries of other-regarding, enlightened stewardship and suggests that incorporating elements akin to section 172 of the UK Companies Act 2006 could provide much-needed clarity and guidance on the purpose of stewardship.

Keywords: enlightened stewardship, investment chain, stewardship codes, institutional investors, end investors, ESG, purpose

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Forthcoming *Current Legal Problems*, Vol 77 (2024)

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1. *Introduction*

The adage, 'the greatest danger in times of turbulence is not the turbulence; it is to act with yesterday's logic',[1] aptly captures the crux of the ongoing debate surrounding the role of institutional investors – both asset owners (pension funds, insurance companies, investment trusts and other collective investment vehicles) and asset managers (with delegated responsibility for the day-to-day management of the scheme's assets) – in shaping capital markets, the economy, environmental sustainability and societal welfare.[2] The UK asset management industry alone manages approximately £11 trillion in assets (including shares, bonds, and alternative investments), making it the second-largest globally after the US.[3] By the end of 2020, institutional investors held 62% of the market capitalisation in UK public equities, according to the OECD.[4] While institutional investors have emerged as 'nuclei of power'[5] in financial markets over recent decades, the critical factor requiring attention is that they manage 'other people's money',[6] imposing responsibilities to act in the best interests of 'others'.

Historically, the discourse around institutional investors has been firmly rooted in agency theory.[7] In corporate governance, institutional shareholders are conceptualised as principals who rely on managers to run companies on their behalf. In the investment

[1] This famous (mis)quotation attributed to Peter Drucker has likely endured because it aligns well with his other statements. See: Peter Drucker, *Managing in Turbulent Times* (Routledge 1980), p.X (Preface): 'A time of turbulence is a dangerous time, but its greatest danger is a temptation to deny reality'.

[2] The term 'asset manager' is preferred here, following the UK stewardship codes, while the Pensions Act 1995 uses 'fund manager' and the Law Commission uses 'investment manager'. The term 'institutional investors' is used broadly to include both asset managers and asset owners, such as pension funds and insurance companies. This contrasts with the narrower definition in the amended European Union's Shareholder Rights Directive, which defines institutional investors as entities engaged in life assurance, reinsurance and occupational retirement. See Council Directive 2017/828/EU of 17 May 2007 amending Directive 2007/36/EC, as regards the encouragement of long-term shareholder engagement [2017] OJ L 132/1, Art. 2(e) (SRD II).

[3] Financial Conduct Authority, *Updating and improving the UK regime for asset management* (DP23/2, February 2023), 8.

[4] OECD, *The Future of Corporate Governance in Capital Markets Following the COVID-19 Crisis* (2021), Figure 2.32.

[5] Adolf A. Berle, *Power without Property: A New Development in American Political Economy* (Harcourt, Brace & World Inc. 1959), 53.

[6] John Kay, *Other People's Money: Masters of the Universe or Servants of the People?* (Profile Books 2015).

[7] Nitesh Pandey, Christian Andres and Satish Kumar, 'Mapping the corporate governance scholarship: Current state and future directions' (2023) 31 Corp Gov 127, 137.

management realm, investors are viewed as either principals (asset owners) or agents (asset managers), depending on their position in the investment chain. This agency theory perspective emphasises dyadic market and contractual relationships between an agent and a principal and suggests various monitoring and control mechanisms to address conflicts of interests.[8] However, it fails to capture the complexity of the investment chain, which involves a web of interconnected transactions and relationships among multiple principals and agents. Moreover, it neglects the broader impact institutional investors have on the real economy, environment and society.

Coupled with the pressing need to address the challenges of 'investor-led sustainability', [9] these limitations call for a fundamental shift in perspective. This paradigm shift involves a comprehensive reevaluation of the roles, motivations, and obligations of institutional investors, emphasising the need to serve a diverse range of 'unseen' others beyond their immediate clients and beneficiaries. Such a shift is crucial as opinions on the role, influence and potential of institutional investors vary widely among scholars and policymakers.[10] With no consensus on whether the considerable power held by institutional investors should be preserved, restricted or eliminated altogether, the urgency of this paradigm shift is underscored.[11]

Enlightened investor stewardship is presented in this article as an alternative and transformative analytical framework that should be adopted to balance institutional investors' powers and responsibilities. Although not a legal term, the notion of investor stewardship has been formalised with the proliferation of non-mandatory stewardship codes across 23 jurisdictions in under fifteen years.[12] Despite significant contributions to the global development of stewardship codes,[13] a comprehensive understanding and consensus

[8] For a recent critical view on the prevailing dyadic theory of agency, see Edward J. Zajac and Maria Goranova, 'When the Principal Is the Firm's Problem: Principal Costs and Their Corporate Governance Implications' (2024) online Acad Mgmt Rev

[9] Juxtapose Wolf Georg Ringe, 'Investor-Led Sustainability in Corporate Governance' (2022) 7 93 with Paul G. Mahoney and Julia D. Mahoney, 'The New Separation of Ownership and Control: Institutional Investors and ESG ' (2021) 2021 Colum Bus L Rev 840.

[10] The proposed changes to the UK listing rules that roll back existing investor protections is an illustration of how deeply divided the policy mind is over this issue. Financial Conduct Authority, *Primary Markets Effectiveness review - Feedback to DP22/2 and proposed equity listing rule reforms* (CP23/10, May 2023); Financial Conduct Authority, UK Listing Rules Instrument 2024 (FCA 2024/XX).

[11] See, for example: Amil Dasgupta, Vyacheslav Fos and Zacharias Sautner, 'Institutional Investors and Corporate Governance' (2021) 12 Found Trends Fin 276; Robin Wigglesworth 'The power of twelve' *Financial Times* 18 June 2022.

[12] Dionysia Katelouzou and Dan W. Puchniak, 'Global Shareholder Stewardship: Complexities, Challenges and Possibilities' in D. W. Puchniak and D. Katelouzou (eds), *Global Shareholder Stewardship* (Cambridge University Press 2022), 3.

[13] See contributions in Dionysia Katelouzou and Dan W. Puchniak (eds), *Global Shareholder Stewardship* (Cambridge University Press 2022).

regarding the essence of investor stewardship is still lacking.[14] The term suffers from inconsistent usage among policymakers, regulators, institutional investors, and consumers alike.[15] This inconsistency hinders progress in developing an analytical framework, let alone a comprehensive theory, of investor stewardship. This article seeks to address this gap.

It begins by exposing the limitations of dyadic principal-agency relationships (Section 2) and by defining a three-dimensional analytical framework for institutional investors as stewards diving into diverse literatures (Section 3). Institutional investors exercise *power* and influence over their investment portfolios *on behalf of others,* their clients and/or beneficiaries, while also *acting for* a broader spectrum of 'unseen' others, including end investors, investable assets, and the broader economy, environment, and society.[16] Unlike agents, who are typically modelled as self-interested profit maximisers for their immediate contracting parties, stewards are other-serving actors. In other words, stewards serve multiple 'principals' in agency terms, highlighting a critical limitation of agency theory, which cannot adequately address situations involving multiple principals.

Second, the investor stewardship framework points to a crucial yet under-explored observation: the interests of these broader *others* served by an investor steward may not align with those of the clients and/or beneficiaries. To elaborate on this distinction, Section 4 conceptualises the investment chain as a framework encompassing *multiple stewardship relationships*. It identifies four primary stewardship relationships: (1) *client stewardship,* (2) *end-investor stewardship*, (3) *asset stewardship*, and (4) *sustainability stewardship,* based on whom the stewardship activity is designed to benefit. These stewardship relationships are not mutually exclusive; instead, they can have complementary and mutually reinforcing effects. However, they can also give rise to conflicting interests and ambiguity regarding the duties of institutional investors towards their various stakeholders, including clients, beneficiaries, end-investors, and broader societal and environmental interests.[17] *Enlightened stewardship* is introduced as an overarching model that integrates

[14] A similar lack of consensus exists on the meaning of sustainable finance or the acronyms associated with it, that is ESG (environmental, social and governance), SRI (socially responsible investing) and CSR (corporate social responsibility). See: Laura T. Starks, 'Presidential Address: Sustainable Finance and ESG Issues—Value versus Values' (2023) 78 1837.
[15] See, for example: Cameron Gilchrist and others, *Matter of fact-sheets: improving consumer comprehension of financial sustainability disclosures* (Financial Conduct Authority, Occational Paper 62, October 2022), 5, 29.
[16] This is a normative observation rather than a positive one. Whether institutional investors act as stewards rather than agents and the extent to which they act for others are empirical questions that future work should address.
[17] These duties are not always hard law obligations but can also arise from stewardship codes, ethical considerations, and societal expectations. See, further, Section 5.

all these relationships. An enlightened steward acts on behalf of their clients and/or beneficiaries and, in doing so, regard the best long-term interests of all 'others' involved, thus balancing immediate responsibilities with broader impacts.

While an inevitable simplification of a complex investment reality cannot be avoided, this article advances scholarship by casting the role of institutional investors within an enlightened stewardship framework, moving beyond 'yesterday's logic'. By focusing on the relationship between asset managers and asset owners, it becomes clear that the traditional dyadic agency-principal framework is no longer sufficient to address the intricacies and broader responsibilities inherent in modern investment management.

In addition to its significant theoretical contributions, the framework of enlightened stewardship carries important normative implications. Notably, all stewardship relationships, except for client stewardship, operate outside the realm of private law. Section 5 below builds on this by examining the UK Stewardship Code 2020,[18] illustrating the potential crowding-in effect of non-mandatory stewardship codes. This effect has been overlooked due to an overemphasis on their role as complements to corporate governance codes.[19] The analysis reveals that the Code's crowding-in role remains incomplete because it currently makes other-regarding, enlightened stewardship dependent on two critical factors: avoiding conflicts of interest and addressing materiality.

Finally, the construct of enlightened stewardship offers a compelling impetus for future research, aiming to better understand and develop the expectations of investor stewards at both positive and normative levels. Such research has the potential to inform policies and market practices that enhance market functionality, create long-term value, and contribute positively to societal well-being. This is particularly pertinent in light of the ongoing review of the UK Stewardship Code 2020 to ensure its continued relevance and effectiveness.[20] By clarifying the scope of enlightened stewardship in a manner akin to section 172 of the UK Companies Act 2006, we can provide much-needed guidance and directions to policymakers and investors alike. This understanding is also crucial for broader discussions around the purpose of stewardship, especially as it intersects with the global

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[18] Financial Reporting Council, *The UK Stewardship Code 2020* (London: FRC, 2019) (UK Code 2020).

[19] The alternative of governing institutions' shareholder behaviour in securities and/or investment management regulation remains outside of the scope of this article. On the broad contours of how this may be achieved, see: Iris H-Y Chiu and Dionysia Katelouzou, 'Making a case for regulating institutional shareholders' corporate governance roles' (2018) J Bus L 67.

[20] Financial Reporting Council, Statement: FRC policy update launch of the UK Stewardship Code 2020 review (27 February 2024); Financial Reporting Council, FRC announces significant update to the UK Stewardship Code (22 July 2024).

trend toward sustainable finance and the corporate purpose debate.[21] As the dialogue around investor stewardship continues to evolve, bringing the 'unseen' others into clear focus and solidifying the framework of enlightened stewardship ensures that stewardship practices remain relevant and impactful amidst times of turbulence and rapid change.

2. *Redefining institutional investors as stewards*

A. Stewardship through time and diverse literatures: the unified theme of serving others

The term investor stewardship is relatively recent, but the concept of stewardship dates back to the Middle Ages. It originates from the Anglo-Saxon *stiweard* or *stigweard*, meaning 'house keeper' or 'house guardian', derived from *stig* (house or part of a house) and *weard* (keeper).[22] Historically, stewardship meant protecting a kingdom in the absence or minority of those in charge.[23]

In scholarly literature, stewardship has varied meanings and uses. For accounting scholars, stewardship primarily refers to management's role within the principal-agent framework. Chen discerns two key stewardship responsibilities of the agent/manager: a (social) stewardship responsibility to society and a (financial) stewardship responsibility to the 'owner' (shareholder).[24] She traces the evolution of stewardship from medieval 'communal stewardship' based on Christian theology of man as 'steward of the God' to early-20th-century 'classical stewardship' focused on financial responsibilities, and mid-20th-century 'managerial stewardship', which views management as 'public stewards' with social objectives.[25] Other accounting scholars similarly position stewardship within the principal-agent relationship, viewing it as exercising *power on behalf of others*.[26] However, this perspective contrasts with the broader understanding of stewardship in other disciplines.

[21] See, for example: Edward Rock (2021) 'For Whom is the Corporation Managed in 2020? The Debate Over Corporate Purpose' 76 Business Lawyer 363; Brian R. Cheffins, 'The Past, Present and Future of Corporate Purpose' (2023) Del J Corp L (Forthcoming); Colin Mayer, *Capitalism and Crises: How to Fix Them* (Oxford Academic, Oxford University Press 2024).
[22] 'steward, n.' *OED Online*. Oxford University Press: https://www.oed.com/dictionary/steward_n?tl=true
[23] Peter Block, *Stewardship: Choosing Service over Self-Interest* (Berrett-Koehler Publishers 1993), Preface, xx.
[24] Rosita S. Chen, 'Social and Financial Stewardship' (1975) 50 Account Rev 533, 535. But for a critical view of shareholders as 'owners', see text to n 107.
[25] *ibid*
[26] For example, Jacob G. Birnberg, 'The role of accounting in financial disclosure' (1980) 5 Account Organ Soc 71.

Management scholars typically view stewardship as an alternative to the agency model of governance.[27] Building upon and extending the ground-breaking stewardship theory of management of Davis, Schoorman and Donaldson, they emphasise service to others as the defining feature of stewardship.[28] Contrary to the agency theory's self-serving economic model of man (*homo economicus*),[29] stewardship theory envisions an other-serving, pro-organisational 'model of man'. Stewards are rational but distinguished by being 'self-actualizing', deriving higher utility from serving others than from self-serving goals.[30] They are driven by *service* and *trust*, not control.[31] While agency theory relies on monitoring and incentives to align with the principal's goals, stewardship operates under a trust-oriented framework, emphasising intrinsic motivation and a sense of duty. Building on the concept of 'psychological ownership', stewardship is viewed as 'an ongoing sense of obligation or duty to others'.[32] Several psychological and situational factors determine whether a manager will act as an agent *or* a steward.[33]

Ethicists and leadership scholars have expanded this other-regarding element of stewardship to a *duty* to create 'covenantal relationships' based on trust and 'virtue', introducing 'ethical stewardship' aimed at creating long-term wealth in the best interests of the principals, various stakeholders, and society.[34] Social accounting research views stewardship as a 'plus form' of *social accountability*, emphasising a distinctive ethos of 'nurturing, respecting and preserving'.[35]

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[27] Recent work, however, views stewardship and agency as two ends of a continuum, with self-interest and other-interest coexisting. See: Morela Hernandez, 'Toward an Understanding of the Psychology of Stewardship' (2012) 37 Acad Manag Rev 172-185; James J. Chrisman, 'Stewardship Theory: Realism, Relevance, and Family Firm Governance' (2019) 43 Entrep Theory Pract 1051, 1052.

[28] James H. Davis, F. David Schoorman and Lex Donaldson, 'Toward a Stewardship Theory of Management' (1997) 22 Acad Manag 20.

[29] Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial behavior, Agency Costs and Ownership Structure' (1976) J Fin Econ 305; Eugege F. Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 J Pol Econ 288 Eugene F. Fama and Michael C. Jensen, 'Agency Problems and Residual Claims' (1983) 26 JLaw Econ 327.

[30] Davis, Schoorman and Donaldson (n 28), 57.

[31] Block (n 23), 6, 41; Morela Hernandez, 'Promoting Stewardship Behavior in Organizations: A Leadership Model' (2008) 80 J Bus Ethics 121, 122-3.

[32] Hernandez (n 27), 174. For a thorough analysis of 'psychological ownership', see Jon L. Pierce, Tatiana Kostova and Kurt T. Dirks, 'Toward a Theory of Phychological Ownership in Organizations' (2001) 26 Acad Manag Rev 298.

[33] Davis, Schoorman and Donaldson (n 28) 27-38.

[34] Cam Caldwell and Ranjan Karri, 'Organizational Governance and Ethical Systems: A Covenantal Approach to Building Trust' (2005) 58 J Bus Ethics 249; Cam Caldwell and others, 'Ethical Stewardship: Implications for Leadership and Trust' (2008) 78 J Bus Ethics 153, 157-9.

[35] Massimo Contrafatto, 'Stewardship Theory: Approaches and Perspectives' in *Accountability and Social Accounting for Social and Non-Profit Organizations*, vol 17 (Emerald Group Publishing Limited 2014) 189.

More recently, ecological scholars have introduced '*corporate biosphere stewardship*', an adaptive, knowledge-based, collaborative process encompassing social and environmental dimensions.[36] This aligns with theological interpretations of stewardship as a duty for nurturing and conserving resources, providing a normative foundation for corporate environmental responsibility.[37]

In corporate governance, stewardship has primarily referred to the role of managers (both senior officers and directors) as pro-organisational, collectivist stewards, contrasting with individualistic and self-serving agents. Managers who act as stewards are intrinsically motivated to maximise organisational values based on trust and 'collective responsibility', unlike agency theory's focus on extrinsic rewards.[38]

From a legal perspective, it is contested whether managers are agents or stewards. Many legal scholars argue that viewing managers as agents is inaccurate because one key element, the principal's 'continuous control' over the agent, is missing in the manager-shareholder relation.[39] Consequently, the agent-principal analogy risks conflating contractual relationships with 'true agency relationships'.[40] In contrast, portraying managers as stewards aligns more with loyalty inherent in their role.[41] Particularly concerning directors, the notion of stewardship directly aligns with their fiduciary duties and the duty of care to the company.[42] While English courts rarely refer to company directors as stewards, when they do, it is in the context of emphasising fiduciary obligations,[43] or obligations

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[36] Carl Folke and others, 'Transnational corporations and the challenge of biosphere stewardship' (2019) 3 Nat Ecol Evol 1396; H. Österblom and others, 'Transnational Corporations, Biosphere Stewardship, and Sustainable Futures' (2022) 47 Annu Rev Environ Resour 609, 610.
[37] Contrafatto (n 35), 183-5.
[38] *ibid* 27-8; Hernandez (n 27), 177-182.
[39] Lynne L. Dallas, 'Two Models of Corporate Governance' (1988) 22 U Mich JL Reform 19, 34-6; Arthur R. Pinto, 'Corporate Governance: Monitoring the Board of Directors in American Corporations' (1998) 46 Am J Comp L Supp 317, 324.
[40] Dallas (n 39), 34.
[41] For example, Lynn A. Stout, 'On the Rise of Shareholder Primacy, Signs of its Fall, and the Return of Managerialism (in the Closet) Berle IV: The Future of Financial and Securities Markets' (2012) 36 Seattle U L Rev 1169, 1171 (speaking of 'corporate directors and professional executives' as seeing themselves as 'stewards or trustees charged with guiding a vital social and economic institution in the interests of a wide range of beneficiaries' rather than 'as mere agents of shareholders').
[42] In the UK the duty of care is not, as it is in the US, a fiduciary duty. For an in depth comparative analysis of the directors' duty of care in the UK and the US, see David Kershaw, *The Foundations of Anglo-American Corporate Fiduciary Law* (Cambridge University Press 2018), Chapters 7 and 8.
[43] *In Plus Group Ltd & Ors v Pyke* [2002] EWCA Civ 370, [2003] BCC 332, 349: 'A directorship brings with it not only voting rights and emoluments but responsibilities of stewardship and honesty, and those who cannot discharge them should not become or remain directors'); *Mitchell v Al Jaber* [2024] EWCA Civ 423 (affirming previous dicta that a director acts as a 'fiduciary steward' for company property even post-liquidation). On company directors as fiduciaries, see generally *Regal (Hastings) Ltd v Gulliver* [1942] UKHL 1. On the circumstances under which fiduciary duties arise, see *Bristol and West Building Society v Mothew* [1998] Ch 1; *Al Nehayan v Kent* [2018] EWHC 333 (Comm).

giving rise to liability as a constructive trustee.[44] Therefore, in legal discourse, stewardship is tied to fiduciary principles rather than purely economic or contractual notions.

In contrast to the focus on managers, shareholders have been largely overlooked within the framework of the stewardship theory of management, except for family (controlling) shareholders. Business and entrepreneurial research often portrays family shareholders as self-actualised, loyal stewards committed to the company's long-term benefit,[45] but this view is debated.[46] In legal discourse the stewardship image of controlling shareholders is contested. Unlike directors, who are bound by duties to the company, UK company law does not impose fiduciary duties on controlling shareholders toward the company or fellow shareholders.[47]

B. Beyond agency theory: unpacking the complexity of modern investment management

It is no surprise, then, that until recently, corporate governance research has almost invariably applied agency theory in a dyadic fashion, portraying *shareholders* as principals, with corporate managers as their agents.[48] Institutional investors, though distinct, have not been exempt from this principal-agent characterisation. When they hold public equity, they serve dual roles: acting as *agents* for their clients and/or beneficiaries, such as investors in mutual funds or pensioners (the principals), and as *principals* in their interaction with company management, who act as their agent. This dual-layered agency relationship has generated theoretical literature on the governance role of institutional investors, reframing the traditional problem of the separation of ownership from control into the problem of the separation of ownership (of shares) from both control and nominal shareholders.[49] In their

[44] *Williams v Central Bank of Nigeria* [2014] AC 1189; *Burnden Holdings (UK) Ltd v Fielding* [2018] AC 857. But on why a director is not a trustee in the full legal sense, see L. S. Sealy, 'The Director as Trustee' (1967) 25 CLJ 83; A. I. Ogus, 'The Trust as Governance Structure' (1986) 36 Univ Tor Law J 186, 191-192.

[45] Isabelle Le Breton-Miller and Danny Miller, 'Agency vs. Stewardship in Public Family Firms: A Social Embeddedness Reconciliation' (2009) 33 Entrep Theory Pract 1169.

[46] *ibid* 1171; Jonathan D. Arthurs and Lowell W. Busenitz, 'The Boundaries and Limitations of Agency Theory and Stewardship Theory in the Venture Capitalist/Entrepreneur Relationship' (2003) 28 Entrep Theory Pract 145; Chrisman (n 27).

[47] Text to n 79.

[48] Catherine M. Daily, Dan R. Dalton and Albert A. Cannella, 'Corporate Governance: Decades of Dialogue and Data' (2003) 28 371, 371-2. On a critical account of the conceptualisation of shareholders as principals, see Eva Micheler, *Company Law: A Real Entity Theory* (Oxford Academic, Oxford University Press 2021), 235.

[49] For a review, see Dasgupta, Fos and Sautner (n 11).

influential 2013 article, Gilson and Gordon highlighted the agency costs of intermediation, which they referred to as 'the agency costs of agency capitalism'.[50]

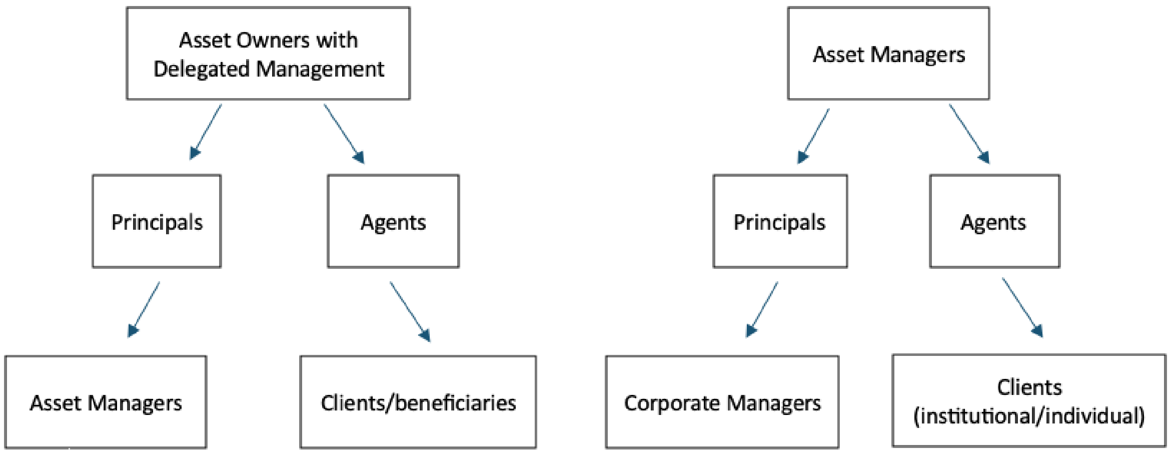

Figure 1: Roles of institutional investors in delegated management within the agency framework

However, while the theoretical literature has, to date, primarily considered dual-layered agency relationships, modern delegated portfolio management is much more complex.[51] For example, when a pension fund delegates portfolio management to an asset manager, it acts as the principal in its relationship with the asset manager but as the agent of its clients and/or beneficiaries, as illustrated on the left side of Figure 1. When investing in public equity, the asset manager, not the pension fund, holds the record of shareholder status and thus possesses the governance rights to act as the principal of the corporate manager,[52] while simultaneously serving as the agent managing the asset owner's funds (right side of Figure 1). Each additional link in the investment chain creates another layer of agency relationships. [53]

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[50] Ronald J. Gilson and Jeffrey N. Gordon, 'The Agency Costs of Agency Capitalism: Activist Investors and the Reevaluation of Governance Rights' (2013) 113 Colum L Rev 863. See also Lucian A. Bebchuk, Alma Cohen and Scott Hirst, 'The Agency Problems of Institutional Investors' (2017) 31 J Econ Perspectives 89 (examining how the behaviour of fund managers deviates from their interests of their clients/beneficiaries in an agency framework).
[51] For a literature review see: Livio Stracca, 'Delegated Portfolio Management: A Survey of the Theoretical Lliterature' (2006) 20 J Econ Surveys 823.
[52] But see Ewan McGaughey, 'Does corporate governance exclude the ultimate investor?' (2016) 16 JCLS 221 (arguing in favour of legal changes to empower the end investors).
[53] For instance, the relationship between a consultant (agent) and the pension fund (principal), or between a proxy service advisor (agent) and an asset manager (principal) introduces additional agency relationships. Additionally, when a nominee company acts as the record owner instead of the institutional investor, another agency layer is created.

These multi-layered agency relationships, including those between institutional investors (who are the record owners) and corporate managers, and between record owners and beneficial owners (clients/beneficiaries), affect the monitoring incentives of institutional investors thereby distorting the stylised agency theory's portrayal of a profit-maximising agent.[54] In addition to the classic hurdles of conflicts of interests and information asymmetries between shareholders and managers,[55] the agency costs arising from the separation between record owners and beneficial owners undermine the incentives and competence of both asset owners and asset managers to effectively monitor their investee companies.[56] This separation results in reduced accountability and engagement, weakening overall governance and oversight mechanisms.[57]

Economists have recognised significant differences between standard agency problems and those in delegated portfolio management. This has led to critiques of the traditional agency framework for inadequately addressing the unique challenges faced by equity-holding institutional investors, who act as both agents and principals within the investment chain.[58] For instance, agency theory typically expects asset owners to focus on identifying the skills of asset managers and measuring their performance relative to a benchmark.[59] This emphasis on power dynamics and monitoring often results in short-term fixes for agency costs, exposing inherent limitations in the traditional agency model.[60]

Furthermore, social financial research and business ethics have demonstrated that the relationship between asset managers and asset owners is more complex than a straightforward principal-agent approach suggests, as there is neither a 'uniform' nor a 'unitary' principal.[61] Every participant in the investment chain may operate in various roles.

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[54] Dasgupta, Fos and Sautner (n 11).
[55] Jensen and Meckling (n 29), 308.
[56] One factor contributing to diminishing monitoring is that the investment model is based on increasing assets under management through superior relative performance.
[57] For the legal and operational complexities of custody chains, see Eva Micheler, 'Custody Chains and Asset Values: Why Crypto-Securities Are Worth Contemplating' (2015) 74 Cambridge L J 505.
[58] Andrew Ang, *Asset Management: A Systematic Approach to Factor Investing* (Oxford Academic, Oxford University Press 2014), 498.
[59] For a critical account of this approach, see Diane-Laure Arjaliès and others, *Chains of Finance: How Investment Management is Shaped* (Oxford Academic, Oxford University Press 2017), 47-8, 67.
[60] See generally: Daniel J. H. Greenwood, 'Fictional Shareholders: For Whom are Corporate Managers Trustees, Revisited' (1995) 69 S Cal L Rev 1021; Paddy Ireland, 'Company Law and the Myth of Shareholder Ownership' (1999) 62 Mod L Rev 32; Simon Deakin, 'The Corporation as Commons: Rethinking Property Rights, Governance and Sustainability in the Business Enterprise' (2011) Queen's L J 339; Lynn A. Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations and the Public* (Berrett-Koehler Publishers 2012); David Ciepley, 'The Anglo-American misconception of stockholders as 'owners' and 'members': its origins and consequences' (2020) 16 J Inst Econ 623.
[61] See Arjaliès and others (n 59), 48 and Guido Palazzo and Lena Rethel, 'Conflicts of Interest in Financial Intermediation' (2008) 81 J Bus Ethics 193, 194, respectively.

For example, asset owners might simultaneously act as agents for their clients and/or beneficiaries while serving as principals for asset managers or corporate managers, depending on whether investment management is delegated.

Another complicating factor is the heterogeneity of institutional investors.[62] They differ in terms of investment models, time horizons, incentives and objectives, such as prioritising liability matching versus maximising returns, as well as in their size and influence. This diversity results in investment chains of varying lengths, complexity and different agency problems.[63] Influence within these investment chains is not unidirectional; it flows both ways (from and to both the principal and agent) and can constitute an interactive, 'cooperative' relationship rather that one based solely on monitoring and control.[64]

While agency theory is useful for analysing conflicts of interests in a dyadic fashion, it cannot easily address situations involving multiple principals.[65] Agents in the investment chain face the challenge of weighing the diverse interests of multiple principals and determining how best to serve them *all*. Investment chains are characterised by diverse relationships that are more malleable and contextually dependent than simple, dyadic principal-agent problems can accommodate. Although it is beyond this article's scope to fully account for the complexity of the investment chain's impact on corporate governance, it is evident that the issues involved in modern investment management impact corporate governance in ways that extend far beyond those addressed by agency theory.[66] In contrast, a stewardship-based approach can provide deeper insights into the multiple roles and responsibilities of institutional investors.

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[62] For example Robert E. Hoskisson and others, 'Conflicting Voices: The Effects of Institutional Ownership Heterogeneity and Internal Governance on Corporate Innovation Strategies' (2002) 45 Acad Mngt 697.

[63] For instance, principal-agent problems are more pronounced when investors seek to maximise returns rather than hedge liabilities because, in the former case, asset managers enjoy greater freedom. Arjaliès and others (n 59), 67.

[64] *ibid*, 51, 68 (showing how larger pension funds have the power to constrain their agents (asset managers), and how asset managers can reshape the relationships with their clients influencing them to align their goals with those of the asset managers).

[65] But see contributions to multiple agency theory in the context of IPOs: Jonathan D. Arthurs and others, 'Managerial Agents Watching other Agents: Multiple Agency Conflicts Regarding Underpricing in IPO Firms' (2008) 51 Acad Mngt J 277.

[66] For early attempts to revamp this understanding, see Iris H. Y. Chiu, 'Institutional Shareholders as Stewards: Toward a New Conception of Corporate Governance' (2011) 6 Brook J Corp Fin & Com L 387; Dionysia Katelouzou, 'Shareholder Stewardship: A case for (Re)Embedding the Institutional Investors and the Corporation?' in B. Sjåfjell and C. M. Bruner (eds), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press 2019).

3. A three-dimensional framework for investor stewardship

Moving beyond the reductionist agency framework uncovers crucial yet underexamined implications regarding the role of institutional investors. Our discourse begins with a three-dimensional analytical framework that defines investor stewardship as comprising three essential elements: (1) a steward has *power*, which is exercised (2) *on behalf of others* and (3) *for others*.

To illustrate these three elements, shareholder stewardship – which encompasses how institutional investors monitor, vote in, and engage with portfolio companies – serves as a pertinent example.[67] When institutional investors invest in public equity, they exercise a 'shared' degree of *power* with management.[68] Under UK company law, institutional investors are not legally obligated to exercise shareholder decision-making power, including voting, unless their ownership stake is substantial enough to confer complete or substantial control over the company.[69] Nevertheless the exercise of shareholder power by institutional investors has spurred extensive literature on shareholder engagement and activism.[70]

Although there is no unanimous agreement on the extent and nature of shareholder power exercised by different types of institutional investors (active, activists and passive),[71] recent developments have reinforced their influence. Key trends include firm-specific

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[67] For investor stewardship beyond public equity, see Dionysia Katelouzou, 'Investor Stewardship: The State of the Art and Future Prospects' in J. N. Gordon and W.-G. Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* (2nd edn, Oxford University Press Forthcoming).

[68] For a definition of power as 'discretion' to make choices with 'significant effects', see: J. E. Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (Oxford University Press 1995), 10. For how power is shared between shareholders and management, see Edward S. Herman, *Corporate Control, Corporate Power: A Twentieth Century Fund Study* (Cambridge University Press 1981) 23. For shareholder power in general, see Lucian Arye Bebchuk, 'The Case For Increasing Shareholder Power' (2005) 118 Harv L Rev 833(n 3); Marcel Kahan and Edward Rock, 'Embattled CEOs' (2010) 88 Texas L Rev 987; Harwell Wells, 'A Long View of Shareholder Power: From the Antebellum Corporation to the Twenty-First Century' (2015) 67 Fla L Rev 1033.

[69] See: *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515 at 532 (applying to pension trustees); The Law Commission, *Fiduciary Duties of Investment Intermediaries* (Law Com No 350, 2014), 3.85-3.88 and 5.96-5.97. The situation is different in the US where both advisers to private pension funds and mutual fund managers owe a duty to vote. See: Interpretive Bulletins Relating to the ERISA of 1974, 59 Fed. Reg. 38,860, 38,863 (1994) (codified at 29 C.F.R. pt.2509.94-2 (1994) and 17 C.F.R. § 275.206(4)-6 (2022).

[70] For literature reviews, see: Maria Goranova and Lori Verstegen Ryan, 'Shareholder Activism: A Multidisciplinary Review' (2014) 40 J Manage 1230; Matthew R. Denes, Jonathan M. Karpoff and Victoria B. McWilliams, 'Thirty years of shareholder activism: A survey of empirical research' (2017) 44 J Corp Fin 405.

[71] On the extent to which large passive managers engage in activism juxtapose, for example, Assaf Hamdani and Sharon Hannes, 'The Future of Shareholder Activism' (2019) 99 BU L Rev 971, 990 with John D. Morley, 'Too Big to Be Activist' (2018) 92 S Cal L Rev 1407.

institutional shareholder activism, particularly hedge-fund-style activism;[72] collaborations or loose alliances between hedge-fund-style activists and intermediary institutional investors;[73] and portfolio-level shareholder activism on ESG issues, often coordinated by third parties.[74] These trends highlight the growing influence of institutional investors and underscore the importance of their stewardship roles in shaping corporate behaviour and promoting sustainable business practices.

The concept of shareholder stewardship has been so closely linked with shareholder power and engagement that, in the early stages of stewardship policy development, the two terms were often used interchangeably.[75] In contrast, the second and third elements of the tripartite framework of investor stewardship – acting on behalf of others and for the benefit of others – have not garnered as much attention. These two crucial aspects of investor stewardship will be analysed in detail in the following subsections.

A. Acting on behalf of others: clients and/or beneficiaries in focus

The true essence of investor stewardship, and what distinguishes institutional investors in their role as shareholders from other minority shareholders, lies in their intermediary nature. Institutional investors exercise power over corporate affairs *on behalf of others*. This delegation of power is central to investor stewardship, a characteristic generally absent in the decision-making power of other minority shareholders.[76]

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[72] The literature on hedge fund activism is voluminous. For literature reviews, see: Alon Brav, Wei Jiang and Hyunseob Kim, 'Hedge Fund Activism: A Review' (2009) 4 Found & Trends in Fin 185; Alon Brav, Wei Jiang and Hyunseob Kim, 'Recent Advances in Research on Hedge Fund Activism: Value Creation and Identification' (2015) 7 Annual Rev Fin Econ 579.

[73] Jean-Pascal Gond and Valeria Piani, 'Enabling Institutional Investors' Collective Action:The Role of the Principles for Responsible Investment Initiative' (2013) 52 Bus & Soc 64. For empirical data *see* Elory Dimson, Oğuzhan Karakaş and Xi Li,'Coordinated Engagements'(2021) (ECGI, Finance Working Paper N° 721/2021)(analysing 31 PRI engagement projects between 2007 and 2015).

[74] On ESG activism, see: Anna Christie, 'The Agency Costs of Sustainable Capitalism' (2021) 55 UC Davis L Rev 875. On why portfolio-level activism aligns better with the practices of large asset managers, see: Jill Fisch, Assaf Hamdani and Steven Davidoff Solomon, 'The New Titans of Wall Street: A Theoretical Framework for Passive Investors' (2019) 168 U Pa L Rev 17, 26; Marcel Kahan and Edward B. Rock, 'Index Funds and Corporate Governance: Let Shareholders Be Shareholders' (2020) 100 BU L Rev 1771, 1800. However, on the limitations of portfolio-level activism, see: Roberto Tallarita, 'The Limits of Portfolio Primacy' (2023) 76 Vand L Rev 511

[75] Dionysia Katelouzou, 'Something Old, Something New: Cultivating Institutional Investor Engagement through Shareholder Stewardship' in L. Enriques and G. Strampelli (eds), *Board-Shareholder Dialogue: Policy Debate, Legal Constraints and Best Practices* (Oxford University Press 2024).

[76] The case of retail investors is illustrative. Even if they become more engaged with the companies they own shares in, their power is not exercised on behalf of another and, therefore, they do not qualify as stewards. On the governance role of retail investors, see Sergio Alberto Ricci and Christina M. Sautter, 'Corporate Governance Gaming: The Collective Power of Retail Investors' (2021) 22 Nev LJ 51; Jill E. Fisch, 'Gamestop and the Reemergence of the Retail Investor' (2022) 102 BU L Rev 1799.

UK company law does not typically view shareholders' voting rights as being conferred for acting in the best interests of others.[77] Despite limitations on the majority shareholder's right to vote in cases of minority expropriation, shareholder rights are considered incidents of share ownership, not delegated by anyone.[78] This explains why, unlike directors, shareholders under UK company law are generally not subject to fiduciary duties to the company or fellow shareholders, and can use their voting power self-interestedly, regardless of the impact on others.[79]

For years, the clear distinction between directors' duties and shareholders' rights, which underpins the traditional view of shareholders as principals and directors as agents, left little room for the concept of shareholders as stewards. However, with the rise of institutional investors, it is debated whether this shareholder-centric position, now often implying an asset-manager-centric one, should be maintained. Legal commentators argue that minority institutional shareholders should have company law duties similar to those of controlling shareholders in jurisdictions like the US,[80] given their influence and the public interest implications of their corporate governance roles.[81] This debate is particularly intense in the case of hedge-fund-style activists.[82] Nevertheless, the current position under English

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[77] Paul L. Davies, *Gower and Davies' Principles of Modern Company Law* (9th edn, Sweet & Maxwell 2012) 692.

[78] See: *Allen v Gold Reefs of W. Africa Ltd* [1900] 1 Ch 656; *Brown v. British Abrasive Wheel Co* [1919] 1 Ch 290; *Dafen Tinplate Co Ltd. V Llanelli Steel Co* [1920] 2 Ch 124; *Northern Counties Securities Ltd v Jackson & Steeples Ltd* [1974] 1 WLR 1133; *Arbuthnott v Bonnyman & 18 Ors* [2015] EWCA Civ 536. See also, *Ebrahimi v Westbourne Galleries Ltd* 2 All E.R. 492, 500 (HL 1972) and section 994 of the Companies Act 2006.

[79] However, when the company is a charity, a member may be fiduciary to the objects of the charity (not the company): see *Lehtimäki v Cooper* [2020] UKSC 33, [2022] AC 155, [2021] 1 All ER 809, [35] and [50]. Even in non-charitable companies, shareholders' duties can be imposed contractually. See: Jennifer Payne, 'Contractual Aspects of Shareholders' Duties' in H. S. Birkmose (ed), *Shareholders' Duties* (Wolters Kluwer 2017), 107. In addition, a range of disclosure duties aimed at transparency are imposed to shareholders of listed companies (via securities regulation). See: Karsten Engsig Sørensen, 'Shareholders' Duty to Disclose' in H. S. Birkmose (ed), *Shareholders' Duties* (Wolters Kluwer 2017), 307. Finally, for an argument in favour of a reasonableness test of shareholder voting, see John Lowry and Ernest Lim, 'Reconsidering the Rule on Shareholders' Exercise of Voting Powers' (2020) J Bus L 345.

[80] See generally: Jerry B. Helwig, 'The Fiduciary Duty of Controlling Shareholders Note' (1955) 7 W Res L Rev 467. But see Paula J. Dalley, 'The Misguided Doctrine of Stockholder Fiduciary Duties' (2004) 33 Hofstra L Rev 175; Jens Dammann, 'The Controlling Shareholder's General Duty of Care: A Dogma that Should Be Abandoned' (2015) 2015 U Ill L Rev 479.

[81] Roberta S. Karmel, 'Should a Duty to the Corporation Be Imposed on Institutional Shareholders?' (2004) 60 Bus Law 1 (for the US); Chiu and Katelouzou (n 19) (for the UK); Ernest Lim, *A Case for Shareholders' Fiduciary Duties in Common Law Asia* (Cambridge University Press 2019), Chapter 3D (for Asia).

[82] Iman Anabtawi and Lynn A. Stout, 'Fiduciary Duties for Activist Shareholders' (2008) 60 Stan L Rev 1255.

law remains that institutional shareholders are not subject to company law duties unless they have substantial control over the company.[83]

When one moves beyond company law, it becomes evident that shareholder rights for institutional investors come with responsibilities. A complex matrix of investment management regulation, case law and agreements between the parties (contracts and trust deeds) stipulates that institutional investors, when investing in public equity, exercise decision-making power over corporate affairs on behalf of their clients and/or beneficiaries.

A strong academic and judicial consensus holds that acting on behalf of others in good faith and for proper purposes is the hallmark of a fiduciary relationship.[84] English case law identifies a fiduciary as someone who acts for another, thereby creating 'a relationship of trust and confidence',[85] and is required to 'act unselfishly' in the best interests of the principal.[86] This element of self-denial distinguishes fiduciaries from other powerholders, who are merely required to act in good faith and for proper purposes.[87]

When it comes to institutional investors, the meaning and scope of the term 'fiduciary' have long been debated.[88] The client agreement (such as between an asset owner and an asset manager) typically establishes an agency relationship in law.[89] While not all institutional investors are subject to fiduciary duties under UK law, they still owe non-fiduciary duties, such as common law duties of care, to those they act for. Most UK institutional investors operate under contracts without holding strict legal trustee status. For instance, in trust-based pension schemes, trustees are bound by fiduciary duties and duties to act in the best interests of their beneficiaries, as established in case law and set out in pensions legislation.[90] In contract-based schemes, providers must act in clients' best

[83] It has been argued, however, that activist (minority) shareholders may be subject to directors' duties if categorised as shadow directors. See David W. Giattino, 'Curbing Rent-Seeking by Activist Shareholders: The British Approach Notes and Comments' (2011) 25 Temp Int'l & Comp LJ 103, 120-122. On shadow directors, see UK Companies Act, s 251, *Re Hydrodan (Corby) Ltd* [1994] B.C.C. 161; *Ultraframe (UK) Ltd. V. Fielding* [2005] All E.R. (D) 397 (Ch.)

[84] L. S. Sealy, 'Fiduciary Relationships' (1962) 20 CLJ 69, 72-9.

[85] *Bristol and West Building Society v Mothew* [1998] Ch. 1 (C.A.), 18 per Lord Millett.

[86] *Al Nehayan v Kent [2018] EW HC 333 (Comm),* [2018] 1 C.L.C. 216, at [159] (Q.B.). See also *Lehtimäki v Cooper* [2020] UKSC 33, at [44]-[46] (Lady Arden) ([t]he key principle is that a fiduciary acts for and only for another … he cannot exercise any power so as to benefit himself).

[87] Sarah Worthington, 'Fiduciaries Then And Now' (2021) 80 CLJ S154, 156-157.

[88] See for example: contributions in James P. Hawley and others (eds), *Cambridge Handbook of Institutional Investment and Fiduciary Duty* (Cambridge University Press 2014).

[89] On investment firms as agents in law, see Lodewijk Van Setten, *The Law of Financial Advice, Investment Management, and Trading* (Oxford University Press 2019), 20-30.

[90] Occupational Pension Schemes (Investment) regulations 2005 (SI 2005/3378), Regulation 4. Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (SI 2013/2734), regs 6, 8 –22, 24 and 25 (pension trustees).

interests per FCA rules.[91] In both cases, established law governs pension funds' roles as stewards to their clients/beneficiaries.

Asset managers holding public equity exercise voting power on behalf of their clients, whether intermediary institutional investors themselves (such as pension funds or insurance companies) or individual (retail) investors. In the former case, assets are typically managed through separately managed accounts, while in the latter, they are handled through collective investment schemes. The role of asset managers as stewards is governed by regulatory requirements, including common law duties of care and, under specific circumstances, fiduciary duties to their clients.[92] When pension trustees delegate investment powers to asset managers, the latter are subject to duties under pension legislation and FCA rules.[93] Additionally, when asset managers invest in collective investment vehicles on behalf of pension trustees, the manager of the collective investment vehicle is bound by the terms of the contract. These rules, while imposing significant responsibilities, do not automatically confer fiduciaries status upon asset managers unless the relationship and contractual terms explicitly establish such obligations.[94]

In conclusion, while institutional investors as shareholders are not typically duty-bound to the company or fellow shareholders, their responsibilities when acting on behalf of their clients and/or beneficiaries are governed by a complex matrix of hard law. However, focusing solely on their role in serving immediate clients and/or beneficiaries can obscure the crucial distinction between an other-regarding steward and a profit-maximising agent. Although both agents and stewards exercise power *on behalf of others*, they differ in two key ways. First, an agent is profit-maximising and self-serving, whereas a steward is self-actualised and other-serving. Second, a steward acts *for* the benefit of a wider range of *others* beyond the immediate contractual parties. This other-regarding element also differentiates a steward from a fiduciary. While both embody trust and unconflicted service, a fiduciary is legally obligated to act in the best interests of their immediate principal in an unselfish way and for proper purposes. In contrast, a steward acts not only on behalf of their direct contractual partners but also for others with whom they have no direct relationship. This

[91] COBS 2.1.1. For a comprehensive analysis see Fiduciary Duties of Investment Intermediaries (n 69), Chapter 8.
92 *Diamantides v JP Morgan Chase Bank* [2005] EWCA Civ 1612; *FM Capital Partners Ltd v Marino and another* [2018] EWHC 1768 (Comm) at [472].
[93] Pensions Act 1995, s 36(1).
[94] *Första Ap-Fonden v Bank of New York Mellon Sa/Nv and others* [2013] EWHC 3127 (Comm) at [175]-[185] (rejecting the plaintiff's claims as 'negligence claims dressed up in fiduciary garb'). See also The Law Commission (n 69), paras. 3.17-3.24 (identifying three key indicators of a fiduciary relationship: 'discretion', 'power to act' and 'vulnerability').

focus on serving a broader range of others is the third analytical subcomponent of the concept of stewardship, which will now be examined in detail.

B. Acting for the 'unseen' others: the distinguishing feature of investor stewardship

While institutional investors, in their role as shareholders, exercise power *on behalf of* their clients and/or beneficiaries, one central question looms: whom should this power ultimately serve? To address this, the notion of psychological ownership, introduced by stewardship theorists, should be revisited.[95] Psychological ownership, unlike legal ownership,[96] transcends contractual relationships and represents a state of mind in which the psychological owner identifies herself with the 'ownable'.[97] Initially, stewardship theorists applied psychological ownership to explain managers' and employees' stewardship behaviours.[98] However, extending this concept to institutional shareholders has been fragmented and incomplete.

Sikavica and Hillman used psychological ownership to develop a behavioural theory of shareholder activism,[99] arguing that minority shareholders' engagement in firm-specific activism depends on psychological ownership. Shareholders with low psychological ownership may opt for exit, while those with a strong sense of ownership but lacking controlling voting power are more inclined to use voice mechanisms.[100] However, their model does not fully explain the conditions under which different activist shareholders and forms of shareholder activism are influenced by psychological ownership,[101] nor does it account for market and institutional factors.[102]

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[95] Text to nn 36-7.

[96] 'Legal ownership' is traced to the theory of property rights and is commonly referred to the bundle of rights provided to shareholders by company law. On the property-right-account of ownership, see John Armour and Michael J. Whincop, 'The Proprietary Foundations of Corporate Law' (2007) 27 Oxford J Leg Stud 429, 437-438. On legal ownership generally see Antony M. Honoré, 'Ownership' in A. G. Guest (ed), *Oxford Essays in Jurisprudence: A Collaborative Work* (Oxford University Press 1961).

[97] Pierce, Kostova and Dirks (n 32), 299.

[98] Hernandez (n 27), 173.

[99] Kate Sikavica and Amy Hillman, 'Towards a Behavioural Theory of Corporate Ownership and Shareholder Activism' (2008) 2008 Acad Manage 1. It should be noted, however, that they define 'shareholder activism' very broadly as including voice, exit and loyalty.

[100] *ibid,* 5.

[101] On the many 'layers' of institutional investors and types of activism, see John C. Coates, 'Thirty years of evolution in the roles of institutional investors in corporate governance' in J. G. Hill and R. S. Thomas (eds), *Research Handbook on Shareholder Power* (Edward Elgar Publishing 2015), 79.

[102] For example: Ruth V. Aguilera and Gregory Jackson, 'The Cross-National Diversity of Corporate Governance: Dimensions and Determinants' (2003) 28 Acad Manag Rev 447.

Management scholars McNulty and Nordberg made a more systematic attempt to apply psychological ownership to institutional shareholders, linking the stewardship theory of management with 'universal' ownership.[103] They distinguish 'active ownership' from mere trading, arguing that institutional shareholders acting as active owners possess both psychological and legal ownership.[104] Active ownership extends beyond shareholder activism to include continuous engagement with a longer-term perspective. Their model suggests that active ownership, like psychological ownership, is a 'cognitive-affective' construct influenced by market and institutional factors.[105] When these forces, such as investors' rewards, investment models and formal rights, emphasise cognitive components and impede affective attachment to the investable asset (companies), exit is more likely than loyalty.[106]

However, replacing the adjective 'psychological' with 'active' is unhelpful because both terms rely on the concept of 'ownership', which becomes vacuous when applied to shareholdings.[107] Both terms face the same challenge of qualifying shareholder stewardship as ownership, causing potential conceptual confusion. The 'feeling' of responsibility inherent in psychological ownership is difficult to apply to minority and highly diversified institutional shareholders.[108] As for the term active ownership, adding 'active' to the already vacuous term 'ownership' contributes little value and may confuse both institutional investors and consumers. 'Active' typically refers to portfolio management, denoting deliberate selection of investments, as opposed to passive portfolio management, which replicates a market index. Consequently, the term 'active ownership' risks excluding stewardship by passive funds that have incentives to (and do) engage at the portfolio level.[109] Another weakness of active ownership is its reliance on legal ownership. In contrast, an investor can act as a steward for others with whom there is no legal relationship, such as end

[103] Terry McNulty and Donald Nordberg, 'Ownership, Activism and Engagement: Institutional Investors as Active Owners' (2016) 24 Corp Gov 346.
[104] *ibid,* 351.
[105] *ibid,* 349-351.
[106] *ibid*, 352.
[107] For example: Ross Grantham, 'The Doctrinal Basis of the Rights of Company Shareholders' (1998) 57 Cambridge LJ 554; Lynn A. Stout, 'Bad and Not-so-Bad Arguments for Shareholder Primacy: Lecture and Commentary on the Social Responsibility of Corporate Entities' (2001) 75 S Cal L Rev 1189.
[108] Pierce, Kostova and Dirks (n 32), 303.
[109] It is also argued that if one examines all the aspects of passive investing it is 'actually very active' from index construction to portfolio management and engagement with companies. See Eric Balchunas 'Five Ways 'Passive' Investing is Actually Quite Active' *Bloomberg* 3 March 2017.

investors.[110] Additionally, both terms fall short in describing investor stewardship beyond of equity.

For these reasons, the inherent other-regarding function of investor stewardship is best understood not as 'psychological' or 'active' 'ownership', but as a predisposition to *act for others*.[111] This sense of responsibility and commitment to act for a diverse array of others, not just immediate clients and beneficiaries, is the hallmark of investor stewardship and distinguishes a steward from both an agent and a fiduciary.[112]

It is important to note that an other-serving steward is not necessarily altruistic; it involves a 'calculated' consideration of the interests of all others involved.[113] Acting for others can include both intrinsic motives and extrinsically motivated calculative behaviour, influenced by social and economic factors.[114] This approach within investor stewardship constitutes a form of 'self-actualizing' *trusteeship* that benefits both self and others.[115] While extensive research on trust exists beyond the scope of this analysis,[116] the key point here is that within the investment chain, there is a combination of formal, private law-driven relationships and multifaceted, trust-based connections.[117] This complexity underscores the limitations of traditional agency theory and highlights the need for a comprehensive stewardship framework to effectively guide and balance the diverse relationships and responsibilities of institutional investors.

4. The multiple relationships of enlightened investor stewardship

[110] See below, Section 4.
[111] Whether societal benefits from investment management are collateral outcomes or primary mandates is beyond this article's scope. Except for impact investing, where generating societal benefits is a primary goal, aligning investment strategies with societal goals is pursued within fiduciary duty and prudent investment management, recognising potential collateral benefits.
[112] See above, Section 3.
[113] Oliver E. Williamson, 'Calculativeness, Trust, and Economic Organization' (1993) 36 J L & Econ 453, 485-486 (considering calculativeness in the context of trust). Cf the notion of 'internalized trust' in Margaret M. Stout Blair, Lynn A., 'Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law' (2000) 149 U Pa L Rev 1735, 1750-1.
[114] On the complexity of motivations, see: Bruno S Frey, *Not Just for the Money* (Edward Elgar Publishing 1997), 14.
[115] But see Colin Mayer, 'Ownership, agency, and trusteeship: an assessment' (2020) 36 Oxford Rev Econ Pol 223235 (adopting a narrower view equating stewardship with 'enlightened self-interest' as opposed to a broader notion of trusteeship which is concerned 'with the interests of others').
[116] See for example: Surendra Arjoon, 'Corporate Governance: An Ethical Perspective' (2005) 61 J Bus Ethics 343; Rene Reich-Graefe, 'Deconstructing Corporate Governance: The Mechanics of Trusting' (2013) 38 Del J Corp L 103.
[117] The emphasis on 'relationships based on trust and respect' across the investment chain is evident in the Kay Review: John Kay, *The Kay Review of UK Equity Markets and Long-Term Decision Making* (July 2012), 44-48.

The preceding analysis, grounded in the three-dimensional stewardship framework, asserts that institutional investors acting as stewards manage assets on behalf of their clients and/or beneficiaries and, in doing so, regard the best long-term interests of all ‘others’ involved. Despite the complexity of investment chains, one critical link in understanding the multifaceted roles of investor stewards is the relationship between asset owners and asset managers, particularly when asset owners lack ‘in house’ fund management capacities. In such cases, when stewardship is delegated, four distinct stewardship relationships can be identified: (1) *client stewardship*, (2) *end-investor stewardship*, (3) *asset stewardship*, and (4) *sustainability stewardship*.[118]

Each term employed to describe these relationships underscores the parties safeguarded by investor stewardship.[119] These relationships are situated within a simplified flow of funds framework, depicted in Figure 2. A lengthy arrow, moving from left to right, outlines the journey of funds from end investors (such as individual savers) to portfolio assets, capital markets and real investment. Additionally, end investors essentially depend on other forms of capital, including human, natural and social capital, as depicted with the dotted start of the arrow. The flow of funds is intermediated by assets owners, asset managers and numerous other parties that are omitted from the figure for simplicity’s sake.[120] All stewardship relationships, except for client stewardship, operate outside the realm of hard law, as depicted by the dotted lines in Figure 2.

(1): client stewardship
(2): end-investor stewardship
(3): asset stewardship
(4): sustainability stewardship

[118] To simplify the terminology, we do not consider other actors of the intermediated securities chain, including brokers and custodians. For an analysis of intermediated securities in the UK, see The Law Commission, *Intermediated securities: who owns your shares? A Scoping Paper* (11 November 2020) and contributions to Louise Gullifer and Jennifer Payne (eds), *Intermediation and Beyond* (Hart Publishing 2019). Also, we do not account for stewardship in relation to ‘secondary financial assets’ owned through collective investment schemes.
[119] The circles represent the parties who may benefit from the investor stewardship exercised by the asset manager when stewardship is delegated.
[120] For the more complex set of ‘buy-side’ and ‘sell-side’ intermediaries that ‘sit between’ savers and capital markets, see Arjaliès and others (n 59), 4-9.

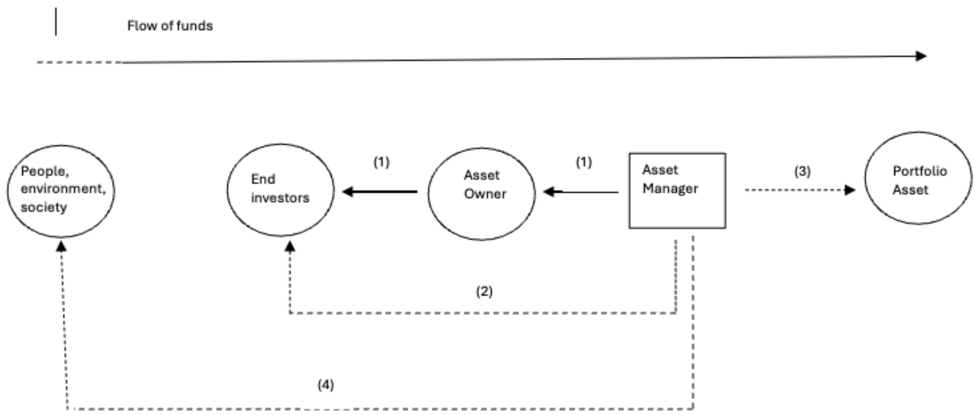

Figure 2: Enlightened stewardship in delegated asset management

Asset owners who delegate stewardship to asset managers still retain shared responsibilities.[121] They act as a *client stewards* (1), exercising power on behalf of and for the benefit of their clients and/or beneficiaries (end investors) as outlined in contracts and trust deeds.[122] When contracting with asset managers to execute investment policies, asset owners maintain stewardship indirectly by setting the terms of their fund mandates and holding asset managers accountable.[123] They are expected to use their influence to ensure that investment managers align their actions with the goals of end investors.[124]

Asset managers then act as *client stewards* (1) for the asset owners (clients), who, in turn, serve as client stewards for their own clients/beneficiaries (end investors). Although both asset managers and asset owners aim to act in the best interests of their immediate client/beneficiaries, conflicts of interest can arise when their incentives differ, such as pursuing strategies that maximise their own fees or short-term performance metrics.[125] These conflicts can overshadow the long-term welfare of end investors. To promote trust

[121] To maintain simplicity in our terminology, we do not account for the potential stewardship role played by service providers, such as investment consultants and proxy advisors. For the relationship between trustees and investment consultants, see *ibid,* 70-75.
[122] text to nn 90-91.

[123] The UK Code 2020 formalises indirect stewardship by asking from assets owners to monitor the stewardship activities of their asset managers and investment consultants. UK Code 2020 (n 18), Principle 8 (Principles for Asset Owners and Asset Managers).
[124] For empirical evidence on the degree of alignment in the voting of asset owners and asset managers, see: Andreas G.F. Hoepner, *UK Asset Owner Stewardship Review 2023: Understanding the Degree & Distribution of Asset Manager Voting Alignment* (2023).
[125] For taxonomies of the conflicts of interest in financial intermediation see: John R. Boatright, 'Conflicts of Interest in Financial Services' (2000) 105 Bus Soc Rev 201; Palazzo and Rethel (n 61).

and confidence throughout the investment chain, *end-investor stewardship* (2) is essential when stewardship is delegated.

This additional layer of stewardship, represented by the dotted line in Figure 2, links asset managers with end investors despite lacking legal recognition. While client stewardship can be argued to implicitly consider the best interests of end investors whose capital is at stake, end-investor stewardship complements and enhances client stewardship by making that additional layer of accountability explicit. This ensures that the long-term interests of end investors are safeguarded, even in the absence of direct contractual relationships.

While relationships (1) and (2) address concerns relating to the governance of stewardship within asset owners and asset managers, ultimately connecting asset managers with end investors, there is also a downstream side of the investment chain involving the investable assets themselves, linking asset management to the market.[126] Here, an *asset steward* (3) exercises power over its assets, such as companies in the case of shareholder stewardship.[127]

While institutional investors exercise shareholder power on behalf of their clients/beneficiaries, and by extension for end investors, they should also consider the interests of the asset itself to promote long term value and sustainable performance. In the context of public equities, the concept of *asset stewardship* is reflected in UK policy initiatives that encourage institutional shareholder engagement. These policies assume that institutional investors are uniquely positioned to hold management accountable and mitigate short-termism through active involvement.[128] Essentially, when an asset owner or asset manager directly invests in a company, they are expected, as a matter of public interest,[129] to undertake a stewardship role. This involves either seeking to change corporate behaviour or exiting investments that do not meet standards of behaviour or sustainability, ultimately aiming to create long-term value.[130]

[126] This is the 'sell-side' of the chain which involves various 'intermediaries, such as brokers or dealers, which are however omitted from the analysis for simplicity purposes.
[127] The term asset stewardship does not imply that the asset, such as a company, is merely an object. Sociologically, the asset can be seen as a subject with its own powers and agency problems. However, this article sets aside this dynamic, despite its importance to the shareholder-management relationship.
[128] Paul Myners, *Institutional Investment in the United Kingdom: A Review* (2001); D. Walker, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities: Final Recommendations* (2009).
[129] On the public-interest aspects of investor-led governance, see Chiu and Katelouzou (n 19).
[130] On exit as stewardship, see for example: Marco Becht, Anete Pajuste and Anna Toniolo,'Voice Through Divestment'(2023) (European Corporate Governance Institute – Finance Working Paper No 900).

At this juncture, it is essential to ask, 'What is the purpose of asset management?' Fundamentally, asset management serves those who entrust their funds (clients and/or beneficiaries) and, by extension, the end investors. Simultaneously, it reallocates investments from individual savers (end investors) to opportunities offering greater potential for the benefit of *others*, including not only the clients/beneficiaries but also the end investors, the investable assets and the broader economy, environment and society.[131]

This dual purpose carries both private and public dimensions. From a private perspective, asset management mitigates risk and generates returns for those who provide the funds, aligning with stewardship relationships (1) and (2). From a public perspective, it serves the real economy and society by facilitating capital allocation, as reflected in asset stewardship (3).[132] Improving the long-term performance of investable assets can positively impact risk-adjusted portfolio returns and benefit stakeholders directly connected to the investable assets, such as shareholders or bondholders. Asset stewardship has been the essence of the first-generation stewardship codes.[133] In the case of shareholder stewardship, it is supported by company law and contracts outlining shareholder rights and obligations, but also involves extra-legal elements such as informal engagement.[134]

Assuming the role of a steward for the broader economy, environment and society, which involves considering the interests of a wider range of stakeholders loosely connected to or external to the investable asset, presents a more complex and less defined role. Traditionally, factors impacting market and systemic risks or driving improvements in the environment, society or overall economy have been considered externalities beyond the scope of business actors.[135] While institutional investors do not hold a monopoly on efforts to mitigate such externalities, their substantial size and market influence make their involvement in 'sustainable development' essential.[136] *Sustainability stewards* (4), driven by intrinsic motivation, extrinsic incentives, or both, aim to foster long-term sustainable

[131] James Hawley and Jon Lukomnik, *The Purpose of Asset Management* (2018).
[132] For the public aspects of shareholder stewardship, see Dionysia Katelouzou, 'Reflections on the Nature of the Public Corporation in an Era of Shareholder Activism and Stewardship' in B. Choudhury and M. Petrin (eds), *Understanding the Company: Corporate Governance and Theory* (Cambridge University Press 2017), 117-144.
[133]
[134] For example: Tim Bowley, Jennifer G. Hill and Steve Kourabas,'Shareholder Engagement Inside and Outside the Shareholder Meeting'(2023) (European Corporate Governance Institute - Law Working Paper No 709/2023).
[135] Luca Enriques and others, 'The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies' in R. Kraakman and others (eds), *The Anatomy of Corporate Law* (3rd edn, Oxford University Press 2017), 93.
[136] *Report of the World Commission on Environment and Development: Our Common Future* (October 1987) <https://sustainabledevelopment.un.org/content/documents/5987our-common-future.pdf>

value that transcends the private contours of (legal, regulatory, or contractual) client-centric duties. While still acting on behalf of their clients and/or beneficiaries, sustainability stewards champion broader public purposes, such as combating climate change and advocating for human rights.

Intrinsic motivations for sustainability stewardship stem from a commitment to ethical investing and responsibility for the societal and environmental ramifications of their actions.[137] This commitment is evident in the public stewardship statements of large asset managers and other investors, who espouse values aligned with sustainable investing practices.[138] Extrinsic motivations include legal and regulatory factors, notably stewardship codes, and compliance with sustainability-related regulations or clients' mandates.[139] Additionally, reputation enhancement in an increasingly active market for stewardship and stakeholder pressure play pivotal roles.[140] Risk mitigation and market opportunities further incentivise sustainability stewardship.[141] Nevertheless, sustainability stewardship may entail significant conflicts of interests and currently lacks legal recognition, as indicated by the dotted line (4) in Figure 2.

The multiple stewardship relationships are not mutually exclusive; they can complement and reinforce each other but also give rise to conflicting interests and ambiguity regarding investor duties. Asset managers, managing portfolios on behalf of asset owners, may assume all four stewardship roles, acting as *enlightened stewards*. An enlightened asset manager acts as a client steward serving the bests interests of their clients (asset owners), and, in doing so, regards the interests of the asset owner's clients and/or beneficiaries acting as an end investor steward. Additionally, they consider the long-term interests of the investable assets, acting as an *asset steward* and address systemic social, environmental and

[137] However, sustainability stewardship is not synonymous with impact investing which typically targets specific positive environmental or social outcomes with a high degree of both intentionality and additionality.
[138] Dionysia Katelouzou, 'The Rhetoric of Activist Shareholder Stewards' (2021) 18 NYU JL & Bus 665.
[139] For instance, within the EU, the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation impose mandatory disclosure requirements on institutional investors. See Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, Official Journal of the European Union no. L 317 of December 12th 2019, p. 1 and Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, Official Journal, No. L 198 of June 22nd 2020, p. 13.
[140] On the demand side of the market for stewardship, see Dionysia Katelouzou and Eva Micheler, 'Investor Capitalism, Sustainable Investment and the Role of Tax Relief' (2022) 23 EBOR 217.
[141] See Elizabeth Pollman,'The Making and Meaning of ESG'(2022) (U of Penn, Inst for Law & Econ Research Paper No 22-23, European Corporate Governance Institute - Law Working Paper No 659/2022) 22 (suggesting that many institutional investors incorporate ESG into investment analysis to improve portfolio-level risk-adjusted returns).

broader economic risks driven by motivations arising from ‘values’, rather than ‘value’,[142] thereby acting as a *sustainability steward*.

Integrating enlightened stewardship within investment management has the potential to empower both the clients and/or beneficiaries of institutional investors and end investors by equipping them with the information needed to direct their capital towards sustainability-aligned investments. However, the overlapping stewardship roles, embodied in the model of enlightened stewardship, complicate the alignment of various interests involved, including financial returns for clients, obligations to meet liabilities (especially pension funds’ contractual obligations to pensioners), long-term benefits for end investors, the interests of the asset itself (which has its own wide array of stakeholders with often conflicting interests),[143] and broader societal and environmental impacts targeted by sustainability stewardship. Aligning these interests requires balancing short-term financial performance with long-term value creation and sustainability, ensuring that asset managers fulfil their stewardship responsibilities across all stewardship dimensions. The next crucial question to consider is: How can the interests of all these ‘others’ be balanced to solidify enlightened stewardship within the regulatory context of investor stewardship?

5. *The ‘crowding-in’ effect of stewardship codes*

To fully grasp the other-regarding function of enlightened stewardship, two groups of ‘others’ have been distinguished: those *on whose behalf* institutional investors act and those *for whom* their actions *ultimately* have consequences. These two groups may not always align perfectly. This section delves into the regulatory aspects of enlightened stewardship, highlighting a crucial distinction: currently, the legally binding duties of institutional investors focus on serving their immediate clients and beneficiaries, whereas it falls to stewardship codes to promote broader, other-regarding responsibilities. After assessing the current limitations of these codes’ crowding-in role, the section concludes by proposing broad contours for incorporating the model of enlightened stewardship into the UK Stewardship Code.

[142] On the difference between ‘values’ and ‘value’, see Starks (n 14), 1837.
[143] In the case of companies, these conflicting interests have given rise to an extending literature on legal and non-legal constraints. For example: Renier Kraakman and others, *The Anatomy of Corporate Law* (3rd edn, Oxford University Press 2017).

A. From client-centric hard-law duties to other-regarding soft-law responsibilities

Legal constraints define the *others* on whose behalf institutional investors act, primarily comprising the beneficiaries of fiduciary trust relationships or the investor's clients, forming the basis of client stewardship (relationship (1) in Figure 2). For pension funds, this entails legally acting on behalf of beneficiaries in trust-based schemes or clients in contract-based schemes.[144] For asset managers, the *others* to whom they owe duties are typically confined, according to English courts, to the immediate contracting party rather than the end investors.[145] This aligns with the structural design of most institutional investors, known as the 'separation of funds and managers'.[146] Regulatory obligations focus on the client and/or beneficiary and extend neither to the relationship between the investment intermediary and the end investors (relationship (2) in Figure 2) nor the relationship between the investment intermediary and the investable asset (relationship (3) in Figure 2).

However, this view of institutional investors' power is narrow and unsatisfactory. While beneficiaries and/or clients are the primary entities on whose behalf institutional investors wield power, public interest concerns suggest that institutional investors should also consider the interests of non-contracting parties, broadening their accountability.[147] In policy circles, the Kay Review highlighted this issue, proposing that all participants in the equity investment chain should bear non-excludable fiduciary obligations to end investors.[148] Connecting end investors with asset management (end-investor stewardship) and the overall health of the economy (sustainability stewardship), is often referred to as the golden 'thread'[149] of stewardship. This 'thread', often overlooked in existing literature on the topic, has played a crucial role in shaping the global development of stewardship codes.

[144] text to nn 90-91.

[145] *Seymour v Caroline Ockwell & Co* [2005] EWHC 1137 at [142] and [143] (rejecting that those who give advice to professional clients owe duties of care beyond their immediate clients). Of course, the asset managers' duties are subject to the investment mandate and English courts have confirmed that fiduciary duties are subject to modification by contract. See, for example: Fiduciary Duties of Investment Intermediaries, (n 69) paras. 10.24, 10.49, 10.51.

[146] John Morley, 'The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation' (2013) 123 Yale L J 1228. For a critical analysis of the implications of this structure on governance, see Roger M. Barker and Iris H-Y Chiu, *Corporate Governance and Investment Management: The Promises and Limitations of the New Financial Economy* (E. E. Publishing ed, 2017), 67-78.

[147] For a broad consideration of 'others' in the fiduciary context, see Neil Stuart Eccles, 'Remarks on Lydenberg's "Reason, Rationality and Fiduciary Duty"' (2018) 151 J Bus Ethics 55, 57-60.

[148] Kay Review (n 117) Recommendation 7 and para 9.9. See also Department for Business Innovation and Skills, *Ensuring equity markets support long-term growth, The Government Response to the Kay Review* (2012), para 2.8 (suggesting that all participants in the investment chain 'should act in the best long-term interests of their clients or beneficiaries').

[149] Ong Boon Hwee and Mark Goyder, *Entrusted: Stewardship for Responsible Wealth Creation* (World Scientific and Stewardship Asia 2020), 129-130 (adopting a much broader concept of stewardship as including stewardship by companies' boards and the state).

Stewardship codes, often criticised for their perceived failure to prompt institutional investors to become active shareholder stewards,[150] actually serve to broaden the scope of client-centric legal obligations. These codes extend beyond immediate clients and/or beneficiaries to include considerations for a broader range of others. They reinforce other-regarding stewardship, supplementing rather than displacing intrinsic motivations. This 'crowding in' effect contrasts with 'crowding out' theories based on behavioural research.[151] The crowding-in effect arises not primarily from enforcement, which is weak due to the non-mandatory nature of the codes, but from an 'expressive' or 'preference-shaping' function.[152] By articulating a social expectation that institutional investors will regard others beyond their clients/beneficiaries, stewardship codes shape investors' behaviour by altering their internal preferences rather than changing external incentives.[153]

In the UK, this crowding-in effect is evident in both generations of the UK Stewardship Code. In its inaugural paragraph, the UK Stewardship Code 2012, often hailed as 'the gold standard of stewardship',[154] emphasised that '[e]ffective stewardship benefits companies, investors and the economy *as a whole*'.[155] This reflects the diverse array of others that institutional investors should consider in their capacity as stewards. However, it is crucial to distinguish between enlightened stewardship and having a fiduciary obligation to act in the interests of others beyond clients and/or beneficiaries. The benefits to a broader range of others may be incidental to the actual stewardship activities undertaken.

The revised UK Stewardship Code 2020 (UK Code 2020) reinforces other-regarding, enlightened stewardship. Contrary to client/beneficiary-centric regulatory duties, the UK Code 2020 serves a crowding-in function by connecting end investors to the well-being of the investable assets. However, intermediation is not an end in itself; the overriding purpose of asset management is to allocate aggregated capital to finance the economy. The UK Code 2020 encourages asset owners and asset managers to 'identify and respond to market-wide

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[150] For example, Brian R. Cheffins, 'The Stewardship Code's Achilles' Heel' (2010) 73 MLR 1004; Simon CY Wong, 'Why stewardship is proving elusive for institutional investors' (2010) 7 406; Arad Reisberg, 'The UK Stewardship Code: On The Road To Nowhere?' (2015) 15 JCLS 217.

[151] Deborah A. DeMott, 'The Domains of Loyalty: Relationships between Fiduciary Obligation and Intrinsic Motivation The Future of Fiduciary Law Symposium' (2020) 62 Wm & Mary L Rev 1137, 1143-7 (focusing on the crowding in effect of fiduciary law).

[152] Blair (n 113) 1744.

[153] *ibid* 1744. See also Konstantinos Sergakis, 'Shareholder stewardship: autonomy and sociality' (2023) 23 JCLS 497.

[154] Financial Reporting Council, *The influence of the UK Stewardship Code 2020 on practice and reporting* (July 2022), 9.

[155] Financial Reporting Council, UK Stewardship Code 2012 (London: FRC, 2012) (UK Code 2012) 1 (emphasis added).

and systemic risks', including geopolitical issues and climate change, and to 'integrate material environmental, social and governance issues, and climate change" into their responsibilities'.[156] In advancing market-wide and ESG stewardship, the UK Code 2020 expands the notion of 'others' to encompass 'the economy, the environment and society',[157] and applauds an even broader stewardship construct, that of the sustainability steward (relationship (4) in Figure 2).

Theoretical support for this broader interpretation of the others whose interests an enlightened steward considers can be found in the universal owner theory, where long-term, large institutional investors effectively become fiduciaries for the broader interests of society.[158] Their financial well-being becomes inseparable from the well-being of the entire economy and society, rather than solely dependent on portfolio performance. Embracing the universal owner theory allows investors to adopt a broader view, considering the impact of their investment decisions on a wider range of others.[159] An alternative theoretical foundation for this approach can be found in sustainable or impact investing principles and fundamental ethical norms, such as human rights.[160] By incorporating these perspectives, institutional investors can advance responsible stewardship practices that account for a wider range of others beyond their immediate clients and beneficiaries.

B. Crafting the enlightened stewardship model in the UK Stewardship Code: drawing inspiration from section 172

To promote enlightened investor stewardship, one regulatory approach is to leverage stewardship codes to expand the notion of others beyond immediate clients and/or beneficiaries.[161] While end-investor stewardship and asset stewardship are recognised –

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[156] UK Code 2020 (n 18) Principles 4 and 7 (Principles for Asset Owners and Asset Managers).
[157] *ibid* 4. Defining broader environmental and societal interests is beyond this article's scope. However, within agency theory, 'people, the environment and society' are typically limited to those 'directed affected' by businesses. See Beate Sjåfjell, 'Sustainability and Law and Economics: An Interdisciplinary Redefinition of Agency Theory' in B. Sjåfjell, R. Russell and M. v. d. Velden (eds), *Interdisciplinary Research for Sustainable Business: Perspectives of Women Business Scholars* (Springer 2022).
[158] James Hawley and Andrew Williams, 'The Emergence of Fiduciary Capitalism' (1997) 5 Corp Gov 206 n 170 above, 206. For an extensive treatment of 'fiduciary capitalism', see James P. Hawley and Andrew T. Williams, *The Rise of Fiduciary Capitalism: How Institutional Investors Can Make Corporate America More Democratic* (University of Pennsylvania Press, Inc. 2000).
[159] Ellen Quigley, *Universal Ownership in the Anthropocene* (2019), 31 (favouring a 'duty of expansion', that is 'the duty of Universal Owners to extend participation to communities and regions of the world currently underrepresented among large institutional investors').
[160] Steve Lydenberg, 'Reason, Rationality, and Fiduciary Duty' (2014) 119 J Bus Ethics 365, 369-371.
[161] Whether hard law duties can be revised to account for other-regarding stewardship is out of the scope of this article, but a preliminary account is included in Chiu and Katelouzou (n 19).

though not always explicitly and to varying extents - within the UK Stewardship Code 2020 and similar codes worldwide,[162] explicitly crafting the enlightened stewardship model within the next generation of UK Stewardship Code is crucial for the code to achieve its crowding-in effect.

Empirical evidence shows that the narrower concept of ESG stewardship has found its place in policy developments, with 84% of global stewardship codes mentioning ESG factors at least once, and only four codes omitting them entirely.[163] Recent revisions of non-UK codes also reflect a stronger focus on ESG.[164] These trends are encouraging and align with policymakers' view of investor stewardship as a crucial avenue for prompting ESG objectives.[165] While ESG stewardship focuses on mitigating negative externalities and enhancing asset (portfolio) value,[166] sustainability stewardship goes further by encouraging issuers to actively contribute to positive societal change, even in areas beyond their direct impact. An enlightened steward is a sustainability steward who balances the interests of all others involved. While acting on behalf of clients and/or beneficiaries, an enlightened steward is dedicated to achieving long-term outcomes that serve end investors, assets and broader environmental and societal values.

Current debates primarily centre on the financial implications of ESG factors.[167] In the UK, the legal status of ESG investing aimed at risk-adjusted returns is generally less contentious than in other countries.[168] It is widely accepted under UK law that pension trustees should always consider *financially material* factors in their investment risk

[162] For a comparative analysis of stewardship codes around the world see: Katelouzou and Puchniak (n 13).
[163] Dionysia Katelouzou and Alice Klettner, 'Sustainable Finance and Stewardship: Unlocking Stewardship's Sustainability Potential' in D. Katelouzou and D. W. Puchniak (eds), *Global Shareholder Stewardship* (Cambridge University Press 2022).
[164] For instance, the 2020 version of the Japanese Code include an ESG-related principle but as explained by Professor Goto investor stewardship in Japan promotes, or at least incentivises, a more short-termist, shareholder-oriented culture among Japanese investors. See Gen Goto, 'The Japanese Stewardship Code: Its Resemblance and Non-resemblance to the UK Code' in D. Katelouzou and D. W. Puchniak (eds), *Global Shareholder Stewardship* (Cambridge University Press 2022).
[165] See for example: Financial Conduct Authority, *Sustainability Disclosure Requirements (SDR) and investment labels* (Consultation Paper, CP22/20, October 2022).
[166] This includes a combination of three approaches: integration, screening and thematic. See PRI, An introduction to responsible investment stewardship (19 February 2021).
[167] For reviews of the mixed empirical evidence on the financial materiality of ESG investing, see Pedro Matos,'ESG and Responsible Institutional Investing Around the World: A Critical Review'(2020) (CFA Institute Research Foundation); Stuart L. Gillan, Andrew Koch and Laura T. Starks, 'Firms and social responsibility: A review of ESG and CSR research in corporate finance' (2021) 66 J Corp Fin 101889.
[168] For example, in the US, whether risk-return ESG investing is permissible is far from settled. Juxtapose Max M. Sitkoff Schanzenbach, Robert H., 'Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee' (2020) 72 Stan L Rev 381, on the one hand, with Matt Cole, *Fiduciary Duties of Public Pension Systems and Registered Investment Advisors* (Harvard Law School Forum on Corporate Governance March 1, 2023), on the other hand.

assessments.[169] Consequently, undertaking ESG stewardship is widely considered as part of an investor's duty to their clients and/or beneficiaries. However, whether institutional investors, including pension trustees, can incorporate social and environmental factors that do not have an immediate impact on financial returns remains contentious.[170]

In this context, one key question is whether an investor steward can serve 'others' beyond their clients and/or beneficiaries when these 'others' are not financially material. Another important consideration is the extent to which an investor steward can serve 'others' when their impact extends to the real world. While English courts are unlikely to support unconditioned stewardship for purely moral or ethical reasons, or the unconditioned allocation of capital to asset managers engaging in such practices,[171] the Law Commission has determined that trustees can consider non-financial factors under specific conditions. Trustees must have good reason to believe that beneficiaries would share their concern, and the decision should not entail significant financial detriment to the fund.[172] Nonetheless, gauging the preferences of clients and/or beneficiaries and translating them into investment decisions presents significant challenges.[173]

The UK Code 2020 does not explicitly regard the consideration of ESG factors as part of institutional investors' duties, though Principle 7 emphasises integrating 'material' ESG issues to best serve clients and/or beneficiaries, including their investment time horizons.[174] The ambiguity lies in whether Principle 7 accommodates financial materiality, focusing on ESG factors' impact on profitability and valuation, or 'double materiality', which considers both financial and 'impact' materiality, including real-world effects.[175] The expanded definition of stewardship in the UK Code 2020, coupled with its focus on ESG, market-wide, and systemic risks, suggests a broader view of materiality. This perspective includes

[169] Fiduciary Duties of Investment Intermediaries, (n 69) para 6.27
[170] Juxtapose *ibid*, paras 5.61-5.62 and Law Commission, *Pension Funds and Social Investment* (2017), para 5.15, one the one hand, with UNEP-PRI, *Fiduciary Duty in the 21st Century: Final Report* , on the other. See also Joakim Sandberg, '(Re-)Interpreting Fiduciary Duty to Justify Socially Responsible Investment for Pension Funds?' (2013) 21 Corp Gov 436, 437.
[171] *Cowan v Scargill* [1985] Ch. 270; *Harries and others v. Church Commissioners for England* [1992] 1 W.L.R. 1241.
[172] Fiduciary Duties of Investment Intermediaries, (n 69) para 5.15. See also PRI and others Fiduciary Duty in the 21st Century (2019) <https://www.unepfi.org/wordpress/wp-content/uploads/2019/10/Fiduciary-duty-21st-century-final-report.pdf> (asserting the compatibility of ESG incorporation with investors' fiduciary duties).
[173] Benjamin J. Richardson, 'From fiduciary duties to fiduciary relationships for socially responsible investing: responding to the will of beneficiaries' (2011) 1 J Sustain Fin Invest 5, 9-11.
[174] UK Code 2020 (n 18) Principle 7 (Principles for Asset Owners and Asset Managers).
[175] On how double materiality is embraced by EU policymakers, see Iris H. Y. Chiu, 'The EU Sustainable Finance Agenda: Developing Governance for Double Materiality in Sustainability Metrics' (2022) 23 EBOR 87.

outcomes considered material due to their real-world impact, regardless of their long-term financial relevance.[176] However, the Code frequently references the interests of clients and/or beneficiaries, raising concerns about whether it exclusively supports stewardship activities falling within the scope of hard-law duties.[177]

Alignment with currently defined hard-law duties for asset owners and asset managers suggests that the UK Code 2020 primarily endorses financially material stewardship on ESG issues (alpha enhancement) and stewardship leading to real impact, which holds value in the long term (beta enhancement). The former can be referred to as ESG stewardship, while the latter as sustainability stewardship, which is embodied within the model of enlightened stewardship. However, the Code does not explicitly require or exclude stewardship addressing 'intrinsic materiality', which pertains to activities generating non-financial real-world impact outcomes.[178]

In essence, the UK Code 2020 does not unconditionally internalise the broader environmental and societal impacts of the asset management business into investment practices. Rather, it stipulates that the economy, the environment, and society are to be considered as long as they are 'material', meaning they affect profitability and valuation of a specific asset/portfolio or impact long-term market returns, and do not undermine the interests of the investors' clients and/or beneficiaries. Conditioning the other-regarding function of investor stewardship on materiality and the avoidance of conflicts of interests poses a significant challenge to enlightened stewardship. Some may more critically contend that the Code prioritises the interests of clients/beneficiaries above all else: 'the best interests of clients and beneficiaries [come] first'.[179]

While this article does not aim to fully resolve the tension between enlightened stewardship and hard-law duties, it highlights the 'regulatory complementarity' between the two. It underscores how soft law can fill gaps left by hard-law duties and support an evolving socially oriented regulatory framework that extends beyond investor stewardship, aiming to

[176] Hans-Christoph Hirt, 'The Future of Stewardship: Time to Take a Step Back' in I. H.-Y. Chiu and H.-C. Hirt (eds), *Investment Management, Stewardship and Sustainability: Transformation and Challenges in Law and Regulation* (Hart Publishing 2023), 319.
[177] There are 31 references to clients and/or beneficiaries in the UK Code 2020.
[178] For a distinction between 'financial materiality', 'impact materiality', 'systemic materiality' and 'intrinsic materiality', see The Investor Forum, *What does shareholder capitalism mean for investors?* (January 2022), 40.
[179] UK Code 2020 (n 18) Principle 3 (Principles for Asset Owners and Asset Managers). For a critical view, see Lorraine E. Talbot, 'Polanyi's embeddedness and shareholder stewardship: a contextual analysis of current Anglo-American perspectives on corporate governance' (2011) 62 NILQ 451.

integrate ESG factors into business decision-making.[180] This expansion of the others for whom investor stewardship is exercised may optimistically be viewed as a Polanyi-like re-embedding of institutional investors into larger society,[181] but caution is warranted.

It is crucial to recognise the existing discrepancy between the regulatory objective of fostering long-termism and the public interest related to other-regarding, enlightened stewardship, on the one hand, and the regulatory means of soft-law, bottom-up, market-driven codes, on the other. While soft-law instruments like stewardship codes can crowd-in enlightened stewardship, they may lack the enforcement mechanisms to ensure widespread compliance or effectively address systemic issues.[182] Additionally, the extent to which enlightened stewardship can genuinely serve the public interest, remains an empirical inquiry beyond the scope of this article. While some evidence suggests that many institutional investors presently hold narrower understandings of their responsibilities,[183] this does not discredit the potential of enlightened stewardship; rather, it underscores its intricate and evolving dynamics.

To clarify the concept of enlightened stewardship and define purposeful and effective stewardship, the UK Stewardship Code could draw inspiration from section 172 of the UK Companies Act 2006, which requires directors to consider the interests of various stakeholders in promoting the success of the company consistent with the 'enlightened shareholder value' model.[184] The analogy between the directors' duty to promote the long-term success of the company and the stewardship role of institutional investors as shareholders is illuminating in several ways. Directors are legally obligated to act in the best interests of the company, ensuring its long-term success and taking into account the impact of their decisions on employees, the community, and the environment, among others. Similarly, institutional shareholders, in their stewardship role, are expected to engage in active oversight of the companies in which they invest, promoting practices that foster long-term value creation for a wide range of others. Both roles emphasise a broader view of accountability that goes beyond immediate contracting parties (companies for directors,

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[180] The PRI's policy regulation database counts 868 policy tools and guidance on ESG. See https://www.unpri.org/policy/regulation-database.

[181] Katelouzou (n 66).

[182] For a detailed analysis of stewardship enforcement, see Dionysia Katelouzou and Konstantinos Sergakis, 'Shareholder Stewardship Enforcement' in D. W. Puchniak and D. Katelouzou (eds), *Global Shareholder Stewardship* (Cambridge University Press 2022).

[183] Katelouzou (n 137).

[184] See generally: Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2012).

clients/beneficiaries for institutional investors) to consider the wider implications of their actions on various, 'unseen' others.

Nevertheless, a clear distinction exists: 'the company director is not a meta-fund manager, handling a portfolio of investments on behalf of a saver'.[185] Instead, directors have a direct duty to the company, while institutional investors, acting as stewards, manage assets on behalf of their clients and beneficiaries, aiming to align their investment strategies with the long-term interests of these stakeholders and the broader market. This nuanced understanding of stewardship reinforces the need for institutional investors to adopt a comprehensive and proactive approach in their governance roles, mirroring the broader responsibilities outlined for company directors under section 172.

By explicitly incorporating a duty to consider not only the clients/beneficiaries' interests but also broader interests, the UK Stewardship Code can define effective and purposeful stewardship, illustrate what it looks in practice, outline how reporting can achieve these goals, and establish clear accountability channels. Much like the concept of the enlightened shareholder – a hypothetical shareholder interested in the long-term – the enlightened steward could offer a normative framework clarifying that while institutional investors have duties to their clients and/or beneficiaries, they also bear a broader responsibility to consider the wider impact of their actions. This model would ensure that institutional investors exercise their power as stewardship not only for their benefit but also considering the 'good of others'.

If accountability lies solely with clients and/or beneficiaries, investor stewardship adds nothing beyond the legal duties institutional investors already owe. However, by explicitly extending accountability in the UK Stewardship Code to include end investors, investable assets, and the broader economy, environment, and society, the purpose of investor stewardship is significantly clarified. While an expanded stewardship purpose may face criticism similar to that directed at the enlightened shareholder value model for prioritising a certain group (shareholders in the case of enlightened shareholder value, clients/beneficiaries in the case of enlightened stewardship),[186] such criticism would be far less contentious in the enlightened stewardship model. This is because the priority given to clients/beneficiaries is already mandated by hard law.

[185] Kay Review, (n 117), 57.
[186] For example: Daniel Attenborough, 'Misreading the directors' fiduciary duty of good faith' (2020) 20 JCLS 73.

The added bonus of taking inspiration from an established company law framework is that it provides a tested basis for implementing similar principles in investor stewardship. Experience with section 172 of the UK Companies Act 2006 can guide balancing the various interests when conflicts arise.[187] The key goal is to set clear outcomes for enlightened stewardship and thereby advance accountability and participation by unseen others. Enhanced stewardship reporting is crucial to this approach. Signatories should report clearly on what they consider purposeful stewardship and explicitly explain how they approach enlightened stewardship, detailing their activities and linking them to specific outcomes. They should illuminate the broader impacts of institutional investors' actions and ensure that the interests of a diverse range of stakeholders are considered when investor stewardship is exercised.

In practical terms, this could mean incorporating specific requirements into the expected revision of the UK Stewardship Code for institutional investors to regularly assess and transparently report on their stewardship purpose and impacts of their investment decisions on various stakeholders, akin to the reporting requirements under section 172 for company directors.[188] By adopting this step, the UK Stewardship Code would not only strengthen its relevance and crowding in function but also set a global benchmark for enlightened stewardship.

6. Conclusion

The investor stewardship framework delineated in this article advances the debate beyond the dual-layered notion of institutional investors as principals *and* agents. An investor steward exercises decision-making power on behalf of and for others, rooted in principles of responsibility and trust. A fundamental aspect, often overlooked, is that the others (clients/beneficiaries) on behalf of whose an investor steward acts may not always align with the others ultimately impacted by the exercise of stewardship. This distinction is fundamental for both policymaking and scholarly inquiry, providing a normative platform that invites discourse.

[187] Andrew Keay, 'Having regard for stakeholders in practising enlightened shareholder value' (2019) 19 118.
[188] Sections 414A and 414CZA of The Companies Act 2006.

Introducing multiple stewardship relationships within the investment chain elaborates this difference by clarifying the key characteristics and objectives of client stewards, end-investor stewards, asset stewards, and sustainability stewards. A significant challenge highlighted by the analysis is that, except for the relationship between an investor and their clients and/or beneficiaries, all stewardship relationships do not fall under the primary domain of hard law. Here, stewardship codes can play a vital role in crowding-in other-regarding stewardship.

Authors of stewardship codes, both private and public, should explicitly define who the 'others' are on behalf of and for whom an investor steward ultimately exercises power. They should consistently work on expanding, complementing, or even substituting narrower notions of others found in hard-law duties imposed on institutional investors via regulation, contracts, or common law. The UK Stewardship Code 2020 presents a promising step in this direction. However, there is still significant progress to be made, as the parameters of this broadening of others largely hinge on hard-law rules centred around client and/or beneficiaries and are conditioned by materiality. Formalising the enlightened stewardship model in the new version of the Code, akin to the enlightened shareholder value model, is a promising avenue.

The primary risk posed by the complex and often conflicting interests of others is the potential to induce paralysis and inaction, allowing asset managers to selectively decide on whose behalf and for whom they act. This could reignite self-interest, regressing the debate to outdated agency-theory assumptions. Next-generation stewardship codes should solidify enlightened stewardship, explicitly defining its purpose and recognising the unseen others, such as end investors, third-party stakeholders, and broader environmental and societal interests, who are not protected by hard law. This broader accountability framework will enhance the effectiveness and relevance of stewardship codes, ensuring that institutional investors not only fulfil their fiduciary duties to clients and beneficiaries but also contribute positively to society at large. This is a crucial gap to fill in times of turbulence and a heightened search for purpose.

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