european corporate governance institute

The Purpose of Investor Stewardship

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Dionysia Katelouzou
Kings College London, University of Cambridge and ECGI

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Abstract

This article delves into the evolving purpose of investor stewardship, reframing it as a pivotal yet underexplored dimension of the broader corporate purpose debate. It critiques the traditional view of stewardship as merely a tool for addressing agency costs and governance failures, exposing the limitations of a shareholder-centric approach in addressing the complexities of today's interconnected investment landscape. Building on the concept of "enlightened stewardship", the article reframes the role of institutional investors, advocating for a delicate balance between serving the immediate financial interests of clients and beneficiaries and addressing the wider concerns of "unseen others", including end investors, investee companies, society, and the environment. Through a critical analysis of the UK Stewardship Code's evolution, the article highlights a transformative shift from narrow, micro-level shareholder engagement to a broader, outcome-focused framework that integrates systemic and sustainability concerns. It tackles the inherent tensions between fiduciary obligations and broader stakeholder interests, advancing a redefined vision of stewardship that aligns profit and long-term value creation with purpose. Ultimately, the article envisions enlightened stewardship as a pragmatic and transformative force for fostering long-term sustainable value creation, shaping a future where financial success and societal progress are inextricably linked.

Dionysia Katelouzou
Reader in Corporate Law
Kings College London
Somerset House East Wing, Strand
London WC2R 2LS, United Kingdom
e-mail: dionysia.katelouzou@kcl.ac.uk

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Dionysia Katelouzou*

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This article delves into the evolving purpose of investor stewardship, reframing it as a pivotal yet underexplored dimension of the broader corporate purpose debate. It critiques the traditional view of stewardship as merely a tool for addressing agency costs and governance failures, exposing the limitations of a shareholder-centric approach in addressing the complexities of today's interconnected investment landscape.

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Through a critical analysis of the UK Stewardship Code's evolution, the article highlights a transformative shift from narrow, micro-level shareholder engagement to a broader, outcome-focused framework that integrates systemic and sustainability concerns. It tackles the inherent tensions between fiduciary obligations and broader stakeholder interests, advancing a redefined vision of stewardship that aligns profit and long-term value creation with purpose.

Ultimately, the article envisions enlightened stewardship as a pragmatic and transformative force for fostering long-term sustainable value creation, shaping a future where financial success and societal progress are inextricably linked.

* Reader, The Dickson Poon School of Law, King's College London; Centre for Business Research, University of Cambridge, Research Associate. I am very grateful to the participants of the "Understanding Corporate Purpose" conference at the Victoria University of Wellington on 11 July 2024 for their constructive comments on an earlier draft and especially to Matteo Solinas and Da Lin. All views, and any errors, are my own. E-mail: dionysia.katelouzou@kcl.ac.uk

I. Introduction

Institutional investors—including asset owners such as pension funds, insurance companies, investment trusts, and other collective investment vehicles, alongside asset managers responsible for the daily management of these assets—occupy a central and influential role in today's financial ecosystem. They collect savings, invest in securities and other financial assets and act as critical corporate governance actors, particularly as cross-border investors.[1] Despite their diversity in risk tolerance, return-maximization strategies, and the maturity of their claims and liabilities, institutional investors share a fundamental characteristic: they manage and oversee "other people's money".[2]

This role inherently aligns with the policy-driven concept of investor stewardship, emphasizing the prudent and responsible management of resources to ensure long-term value creation and sustainability, even in the absence of a legally mandated fiduciary or other regulatory duty.[3] However, this stewardship role raises several critical and interconnected questions: Should institutional investors' responsibilities be confined to maximizing financial returns for their clients and beneficiaries? How well do these financial goals – focused on portfolio value – align with the long-term value creation of individual investee assets, such as companies? Should the remit of investor stewardship extend beyond financial returns to address broader societal concerns, including environmental, social, and governance matters? And, to what extent should investor stewardship reflect the interests of a wider range of stakeholders, including end-investors, investee companies, and society at large?

These questions draw parallels with the broader, ongoing debate over corporate purpose, which centres on whether corporations should prioritize maximizing shareholder value or balance this with a wider set of responsibilities to stakeholders such as employees, customers, and the environment.[4] However, while the corporate purpose debate has drawn considerable attention across academic, policy, and practice circles, the equally significant question of the purpose of investor stewardship has largely flown under the radar, despite its far-reaching implications for both corporate behaviour and societal outcomes.

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[1] For instance, the UK asset management industry alone manages around £11 trillion of assets (shares, bonds and alternative assets) and is the second largest globally after the US based on recent data by the Financial Conduct Authority. See Financial Conduct Authority, *Updating and improving the UK regime for asset management* (DP23/2, February 2023), 8.

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

[3] On how soft law stewardship can be hardened towards investors' duties, see Iris H-Y Chiu and Dionysia Katelouzou, 'Making a case for regulating institutional shareholders' corporate governance roles' (2018) Journal of Business Law 67.

[4] See eg Mayer and Siems in this issue.

This is the gap that this article seeks to fill, focusing on *shareholder stewardship* – a subset of investor stewardship that involves the long-term monitoring and engagement practices undertaken by institutional investors as minority shareholders in investee companies.[5] To address this, Section II traces the evolution of institutional investors' roles, using the UK Stewardship Code as a lens to highlight the shift from their traditional role as "capital allocators" to "shareholder monitors" and, more recently, "enlightened stewards". While this evolution reflects an expanding scope of stewardship, it leaves the fundamental question of its core purpose unresolved.

Section III delves into several factors contributing to this ambiguity, including the relatively recent prominence of institutional investors in corporate governance, the dominance of agency theory framing stewardship narrowly as a tool for addressing governance failures, and the structural complexities of modern investment chains. These factors, coupled with the corporate-governance-centric narrative promoted by the first generation of the UK Stewardship Code, have constrained the understanding of stewardship to a monitoring mechanism focused on mitigating the risks of the ownership-control divide through engagement, voting, and oversight.

Section IV draws on the enlightened model of stewardship, defined as the exercise of power on behalf of clients and/or beneficiaries while extending responsibilities to a broader range of "unseen others," including investee companies, society, and the environment, to articulate the purpose of stewardship. The central argument advanced is that, unlike the corporate purpose debate, which contrasts shareholder returns with stakeholder interests, the central tension in stewardship grapples with the distinct challenge of balancing the immediate interests of direct clients/beneficiaries to other stakeholders. To address these overlapping priorities and navigate conflicts of interests, institutional investors adopt distinct roles—client, end-investor, asset, and sustainability stewardship.

Section V builds on this foundation by aligning stewardship with corporate purpose, emphasizing that enlightened stewardship embodies an intricate balancing act. It underscores the need to align financial goals of clients/beneficiaries with long-term societal impacts, echoing the enlightened shareholder value (ESV) maximization model codified in section 172 of the UK Companies Act 2006. Similar to ESV, enlightened stewardship affirms the primacy

[5] Stewardship by controlling shareholders remains out of the scope of this article. On the stewardship code for family controllers in Singapore, see Dan W. Puchniak and Samantha S. Tang, 'Singapore's Embrace of Shareholder Stewardship: A Puzzling Success' in D. W. Puchniak and D. Katelouzou (eds), *Global Shareholder Stewardship* (Cambridge University Press 2022).

of client and beneficiary interests while recognizing that long-term value creation requires consideration of broader stakeholders, including environmental, social, and governance factors. Just as ESV encourages company directors to account for the impact of their decisions on various stakeholders to promote the long-term success of the company, enlightened stewardship challenges institutional investors to integrate broader considerations into their stewardship practices without undermining their obligations to clients and beneficiaries. To fully reflect this enlightened vision, the UK Stewardship Code's definition of stewardship should be amended to explicitly highlight both the primacy of client and beneficiary interests and the need to incorporate broader stakeholder interests into stewardship practices. Such a definition would not only clarify the scope of enlightened stewardship but also reinforce the Code's role in guiding institutional investors to adopt practices that harmonize profit with purpose, driving sustainable governance and long-term value creation. Section VI concludes.

II. Institutional Investors' Evolving Roles: Insights from the UK Stewardship Code

Institutional investors serve as *capital allocators*, channelling funds into various financial assets such as equities, bonds, real estate, and alternative investments. Acting as intermediaries, they manage and deploy funds on behalf of their clients and beneficiaries, including individuals, pension funds, insurance policyholders, and sovereign entities. Their primary focus has been on assessing market opportunities and risks to allocate capital effectively, aiming to generate returns that align with the financial interests of clients and/or beneficiaries.[6] In this capacity, institutional investors manage risk through portfolio diversification, spreading investments across asset classes, industries, and geographic regions to mitigate market volatility and the potential failure of individual assets. They also play a critical role in providing liquidity to financial markets, ensuring stability and facilitating transactions for other market participants. Investment strategies vary widely, ranging from passive approaches, such as tracking market indices with minimal issuer-specific engagement, to active strategies that involve selecting specific assets and occasionally influencing the management of investee companies or other assets.[7] Ultimately, their goal is on managing risk and achieving financial

[6] While some clients may also have non-financial objectives, such as ethical or social considerations, I focus on the mainstream case of financial objectives driving capital allocation and investment decisions, excluding discussions of impact investing.

[7] By the end of 2023, total net assets in U.S. index funds and index ETFs had grown to $13.3 trillion, representing 48% of assets in long-term investment funds. Actively managed funds accounted for the remaining 52% of assets. See Investment Company Institute, *Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry* (2024). For literature reviews on the corporate governance role of

returns – whether through capital gains, dividends, or interest income – while fulfilling their obligations to clients/beneficiaries and contributing to the growth of assets under management in alignment with institutional goals.

In recent years, however, the scope of institutional investors' role has expanded significantly, moving beyond a sole focus on capital allocation to meet the evolving expectations placed upon them. Taking the case of public equity, institutional investors have emerged as dominant shareholders in global public markets —most notably in the US, the UK, and Canada, where they hold 72%, 63%, and 47% of the market, respectively.[8] Their growing influence, not only over individual companies but also across entire markets, has thrust them into the policy spotlight, with increasing expectations to address issues such as corporate governance, sustainability, and systemic market risks, extending their focus beyond the immediate financial interests of their clients/beneficiaries.

The global financial crisis of 2007/8 marked a turning point in this evolution. It exposed the dangers of shareholder apathy, which had allowed mismanagement to go unchecked, contributing to systemic failures in corporate governance. In response, policymakers called for a more active and engaged approach from institutional shareholders to enhance accountability and address short-termism and governance risks, which could threaten both portfolio performance and market integrity. The UK emerged as a forerunner in this shift – from institutional investors serving primarily as capital allocators to (as policymakers aspired) *shareholder monitors*. The Walker Review in 2009 was a key step in advancing this shift, emphasizing the need for more active institutional shareholder engagement to enhance accountability and mitigate governance risks.[9] Among its key recommendations, the Walker Review proposed renaming the Institutional Shareholders' Committee Code as the "Stewardship Code" and placing it under the purview of the Financial Reporting Council (FRC), a quasi-regulatory body responsible for overseeing the UK Corporate Governance Code.[10]

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active and passive fund managers, see Amil Dasgupta, Vyacheslav Fos and Zacharias Sautner, 'Institutional Investors and Corporate Governance' (2021) 12 Foundations and Trends in Finance 276; Alon Brav, Andrey Malenko and Nadya Malenko,'Corporate Governance Implications of the Growth in Indexing'(2023) (European Corporate Governance Institute – Finance Working Paper No 849/2022; Olin Business School Center for Finance & Accounting Research Paper No 2022/06; Oxford Research Encyclopedia of Economics and Finance, August 2023).

[8] A De La Cruz, Alejandra Medina and Y Tang, *Owners of the World's Listed Companies* (OECD Capital Market Series, 2019), 10-11 (reporting that institutional investors hold 41% of the global market capitalization as of the end of 2017).

[9] D. Walker, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities: Final Recommendations* (2009).

[10] ibid. Recommendations 16 and 17.

The FRC acted on these recommendations by introducing the UK Stewardship Code in 2010, marking a pivotal moment in the formalization of shareholder stewardship.[11] The UK Code 2010 sought to institutionalize expectations for monitoring, engagement, and voting practices to address corporate governance failures. Through shareholder engagement, voting, and "purposeful dialogue", institutional investors were expected to scrutinise key aspects of corporate governance, including board effectiveness, strategic direction, performance, risk management, executive compensation and other governance-related practices.[12]

In 2012, the FRC revised the UK Code 2010 to strengthen its effectiveness and address specific challenges identified in the Kay Review, particularly the lack of trust across the investment chain.[13] The two iterations of the code, often referred to as the "first-generation" or "1G" UK Stewardship Code, were closely related in structure and objectives.[14] Adopting a principles-based approach, the 1G UK Code introduced seven principles of effective stewardship designed to guide institutional investors—both asset owners and asset managers—in fulfilling their stewardship roles.[15] These principles emphasized active monitoring of investee companies, conflict-of-interest management, collective engagement and escalation when warranted, and transparency in voting and reporting practices. Much like corporate governance codes, it relied on a comply-or-explain framework, providing flexibility while establishing expectations for behaviour. However, the 1G UK Code remained largely voluntary, applying only to institutional investors who choose to become signatories, except for FCA-authorized asset managers, who were required to disclose whether their commitment to the Code or explain their non-compliance.[16]

While the two iterations of the Code shared a consistent core purpose—enhancing long-term returns and governance through firm-specific engagement—the 2012 revision expanded

[11] Financial Reporting Council, The UK Stewardship Code, (July 2010), https://www.frc.org.uk/getattachment/e223e152-5515-4cdc-a951-da33e093eb28/UK-Stewardship-Code-July-2010.pdf [hereinafter UK Code 2010].
[12] UK Code 2010, 1.
[13] John Kay, *The Kay Review of UK Equity Markets and Long-Term Decision Making* (July 2012), 9-10.
[14] 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), 199.
[15] The 1G UK Code also applied, by extension, to service providers, such as proxy advisors and investment consultants. UK Code 2012, 2.
[16] Financial Conduct Authority, Conduct of Business Rule 2.2.3. Following the 2018 changes to the Occupational Pension Schemes (Investment) Regulations 2005, trustees of occupational pension schemes with 100 or more members are required to publicly state their engagement and stewardship activities via the Statement of Investment Principles. On how the Implementation Statement requirements align with the UK Stewardship Code, see Department for Work & Pensions, Reporting on Stewardship and Other Topics through the Statement of Investment Principles and the Implementation Statement: Statutory and non-Statutory Guidance (17 June 2022).

its focus to encompass not only corporate governance but also investment management aspects of stewardship.[17] It highlighted how effective stewardship creates value not only for companies but also for "the ultimate providers of capital" and the wider economy, though it did not yet prioritize social or environmental considerations to the extent seen in later stewardship codes.[18] Additionally, the UK Code 2012 underscored the shared responsibility for stewardship between company boards and institutional investors, emphasizing that effective governance requires collaboration.[19] It also highlighted the pivotal role of asset owners in shaping stewardship practices by setting expectations and standards that guide the behaviour of asset managers, thereby improving "the functioning of the market for investment mandates".[20]

Despite these nuanced differences, the 2010 and 2012 versions of the UK Stewardship Code remained fundamentally aligned in centring *firm-specific, micro-level shareholder engagement* as the primary mechanism of stewardship,[21] a focus that has earned them the moniker of an "Engagement Code".[22] Engagement encompasses a spectrum of activities, including formal means like exercising voting rights, as well as informal means, such as dialogue, letter writing and meetings. Moreover, it extends to collaborative activities with other investors or participating in collective initiatives or advocacy efforts.[23] Additionally, engagement strategies vary in their assertiveness, ranging from softer approaches to more confrontational strategies when progress in stewardship outcomes stalls.[24] In the context of public equities, escalation may involve shareholder resolutions or requisitioning a general meeting.

The 1G UK Code ignited the global stewardship movement, establishing a framework that has since inspired the adoption of stewardship codes in 23 jurisdictions beyond the UK, as well as at the EU and international levels.[25] Often regarded as the "the gold standard of

[17] For an early account of the two sides of stewardship – corporate governance side and investment management side – 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).
[18] Financial Reporting Council, The UK Stewardship Code (2012), <https://www.frc.org.uk/getattachment/d67933f9-ca38-4233-b603-3d24b2f62c5f/UK-Stewardship-Code-(September-2012).pdf>, para 1.
[19] UK Code 2012, para 2.
[20] UK Code 2012, para 6 and page 2.
[21] Dionysia Katelouzou, 'The Rhetoric of Activist Shareholder Stewards' (2021) 18 New York University Journal of Law & Business 665, 681.
[22] Paul Davies, 'The UK Stewardship Code 2010–2020: From Saving the Company to Saving the Planet?' in D. Katelouzou and D. W. Puchniak (eds), *Global Shareholder Stewardship* (Cambridge University Press 2022), 47.
[23] UK Code 2012, Principle 5.
[24] UK Code 2012, Principle 4.
[25] 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.

stewardship",[26] the 1G UK Code served as a model for many subsequent codes, which primarily aimed to position institutional investors as shareholder monitors. The volume *Global Shareholder Stewardship*, co-edited with Professor Dan Puchniak, offers a comprehensive, comparative, and empirical analysis of 46 stewardship codes, 38 of which were issued after the introduction of the UK Stewardship Code in 2010.[27] Since the publication of the volume, ten additional stewardship codes have been introduced, including a New Zealand Code, bringing the total to 56.[28] This total includes 49 jurisdiction-specific codes spanning 24 jurisdictions across six continents—20 in Europe, 16 in Asia, 5 in North America, 3 in Africa, 3 in Oceania, and 2 in South America—and seven regional or international codes.[29]

Despite its global influence and the growing prominence of stewardship frameworks it inspired worldwide, the 1G UK Code faced substantial criticism at home for its limited effectiveness in fostering meaningful shareholder engagement. Early assessments highlighted its modest impact, noting that domestic institutional investors—the Code's primary target—hold a diminishing share of UK equities, with overseas investors, hedge funds, and private individuals dominating share registers.[30] The Code's design rested on the assumption that investors were naturally incentivized to prioritize long-term corporate success, a premise often at odds with the realities of their business models and duties.[31] Its firm-specific, micro-level stewardship model, centred on monitoring and oversight at the individual company level, frequently clashed with the operational and financial constraints faced by many institutional investors, such as limited capacity and misaligned incentives, which often render micro-level shareholder engagement impractical.[32] Modern portfolio theory and diversification principles discourage firm-specific involvement unless the benefits clearly outweigh the costs, and passive funds, in particular, tend to engage at the portfolio level aiming to maximize portfolio-level value rather than firm-value value.[33] Additionally, deficiencies in key areas such as

[26] Financial Reporting Council, *The influence of the UK Stewardship Code 2020 on practice and reporting* (July 2022), 9.
[27] Dionysia Katelouzou and Dan W. Puchniak (eds), *Global Shareholder Stewardship* (Cambridge University Press 2022).
[28] Stewardship Code Aotearoa New Zealand (September 2022) https://stewardshipcode.nz
[29] See, further, 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).
[30] Brian R. Cheffins, 'The Stewardship Code's Achilles' Heel' (2010) 73 The Modern Law Review 1004.
[31] See generally Roger M. Baker and Iris H-Y Chiu, *Corporate Governance and Investment Management: The Promises and Limitations of the New Financial Economy* (Edward Elgar Publishing 2017).
[32] Katelouzou , 709-717 (arguing that the model of micro-level shareholder stewardship better fits the so-called activist shareholder stewards). See also Bobby V. Reddy, 'The Emperor's New Code? Time to Re-Evaluate the Nature of Stewardship Engagement Under the UK's Stewardship Code' (2021) 84 The Modern Law Review 842 (critiquing the limitations of what he terms "issuer-specific stewardship").
[33] See e.g. Jeffrey N. Gordon, 'Systematic Stewardship' (2021) 47 J Corp L 627.

conflict-of-interest management and collective engagement reporting further undermined the Code's effectiveness.[34] By 2018, the Kingman Review criticized the Code as "not effective in practice", cautioning that it risked devolving into a box-ticking exercise focused on boilerplate compliance rather than meaningful engagement.[35]

In response, the FRC undertook a comprehensive revision, introducing a new version in 2020.[36] This "second generation" or "2G" UK Code expanded and redefined stewardship, accommodating a broader range of investment assets, models and practices, while shifting towards an apply-and-explain, outcome-focused approach.[37] The 2G UK Code redefined stewardship as "the responsible allocation, management, and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society".[38] Moving beyond the earlier versions' narrower focus on shareholder stewardship to improve corporate governance and increase long-term shareholder value, the 2G UK Code introduced twelve principles for asset owners and asset manager reflecting its more holistic approach.[39] A significant addition to the 2G UK Code is the explicit integration of environmental, social, and governance (ESG) factors into the stewardship process.[40] Investors are expected to consider climate change and other material social and governance issues in their investment decisions and stewardship practices.[41] Moreover, the 2G UK Code places heightened importance on identifying and responding to market-wide and systemic risks, including climate change and financial instability,[42] positioning institutional investors to evolve from shareholder monitors to *enlightened stewards*.[43]

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[34] See e.g. The Investor Forum, *Review 2023* (2023) (highlighting the continuing decline in the appetite for collective engagement).

[35] John Kingman, Independent Review of the Financial Reporting Council (December 2018) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf>.

[36] Financial Reporting Council, The UK Stewardship Code 2020 (2019), <https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf>.

[37] On a typology of the varieties of investor stewardship that highlights the expanding levels, actors, assets, motivations and means of stewardship, see Dionysia Katelouzou, *The Path to Enlightened Shareholder Stewardship* (Cambridge University Press Forthcoming).

[38] UK Code 2020, 4.

[39] The Code also introduces six separate principles for service providers. UK Code 2020, 23-29.

[40] For an analytical critique of the term ESG and its consequences, 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)

[41] UK Code 2020, Principle 7.

[42] UK Code 2020, Principle 4. This so-called system-level stewardship is intended to impact beta risks that affects the broader market dynamics

[43] See Section IV below.

Outside the UK, such a radical shift has not been observed, even though some more recent iterations of non-UK stewardship codes have placed greater emphasis on ESG issues.[44] I have argued elsewhere that, despite the global diffusion of UK-style stewardship codes and the dynamic evolution of the UK's gold standard, non-UK codes currently appear to be in a state of developmental stasis or near stasis.[45] Yet, even within the UK, where the evolution of the UK Stewardship Code reflects a substantive broadening of institutional investors' roles—from passive capital allocation to active shareholder engagement and beyond—questions about the underlying rationale and broader objectives of stewardship remain insufficiently scrutinized.

III. The Overlooked Purpose of Stewardship: Challenges and Complexities

While the UK Stewardship Code has been instrumental in institutionalizing shareholder stewardship and setting a benchmark for global frameworks, it leaves critical questions unanswered. Chief among them are the underlying rationale and broader objectives of stewardship activities, which have received insufficient scrutiny. This gap can be attributed to several historical, conceptual, structural, and policy factors that warrant closer examination.

One key factor is temporal: although the origins of institutional investment can be traced back to the late 17th century, it was only in the mid-20th century that institutional investors emerged as dominant holders of publicly traded companies.[46] Consequently, it is only in recent decades that their role in corporate governance has come into focus, giving rise to the ideal of shareholder monitors. This relatively recent shift has concentrated primarily on addressing immediate governance and market concerns, leaving little time for critical scrutiny of the broader purpose of stewardship. Compounding this temporal factor is the conceptual complexity of investor stewardship itself, which further complicates efforts to engage in deeper inquiries into its underlying rationale and scope.

The evolution of institutional investors' roles from capital allocators to shareholder monitors is deeply rooted in agency theory, a framework that has dominated academic and

[44] For example, the 2020 version of the Japanese Code includes an ESG-related principle, but as Professor Goto explains, it continues to promote, or at least incentivize, a more short-term, shareholder-focused 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).
[45] Katelouzou , Investor Stewardship: The State of Art and Future Prospects, 16-22.
[46] See e.g. Janette Rutterford and Leslie Hannah, 'The Rise of Institutional Investors' in D. Chambers and E. Dimson (eds), *Financial Market History: Reflections on the Past for Investors Today* (CFA Institute Research Foundation 2016).

policy discussions for decades.[47] Agency theory offers a straightforward premise: in modern public corporations, the separation of ownership (shareholders) and control (corporate managers) creates potential conflicts of interest, where managers may prioritize their own objectives over those of shareholders.[48] To address this, institutional minority shareholders – acting as principals – were envisioned as key monitors of corporate management, tasked with mitigating these agency costs and ensuring that executives act in the best interests of shareholders.[49]

As discussed earlier, the model of the 1G UK Code epitomized this vision of institutional shareholder monitoring by framing stewardship as a means to enhance long-term shareholder value and improve corporate governance. It institutionalized the expectation that institutional shareholders would actively engage with investee companies at the firm-specific level to address short-termism and corporate governance failures. However, this corporate-governance-focused approach offered a narrow understanding of stewardship's purpose, prioritizing alignment with shareholder interests. This framing largely overshadowed the investment management side of stewardship, which centres on serving the interests of investors' clients and/or beneficiaries.[50]

When institutional investors assume the role of shareholder monitors, they do so *on behalf of others*.[51] For pension funds, this entails legally acting on behalf of beneficiaries in the case of trust-based pension funds or clients in the case of contract-based pension funds. In the case of asset managers, their obligations, as defined by regulation, contracts and common law, are generally confined to their immediate contracting party, not the ultimate end investors. This reflects the structural design of most institutional investors, commonly referred to as the "separation of funds and managers", which creates a distinct division between asset manager

[47] See e.g. Roberta Romano, 'After the Revolution in Corporate Law' (2005) 55 Journal of Legal Education 342 (arguing that finance and economics, particularly agency theory, represent "the conventional analytical approach to corporate law").
[48] Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial behavior, Agency Costs and Ownership Structure' (1976) Journal of Financial Economics 305; Michael C. Jensen, 'Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers' (1986) 76 American Economic Review 323.
[49] The literature on shareholder monitoring as a means to mitigate the agency costs is vast: e.g. Bernard S. Black, 'Agents Watching Agents: The Promise of Institutional Investor Voice' (1992) 39 UCLA Law Review 811; Lucian Arye Bebchuk, 'The Case For Increasing Shareholder Power' (2005) 118 Harvard Law Review 833.
[50] Nevertheless, a content analysis of a sample of 50 signatories' statements to the UK Code 2012 reveals that asset managers demonstrate a clear understanding of their duty to serve their clients' interests, even though this is not explicitly prioritised by the Code. See Katelouzou , The Rhetoric of Activist Shareholder Stewards, 724 and 732.
[51] See, further, Dionysia Katelouzou, 'The Unseen 'Others': A Framework for Investor Stewardship' (2024) 77 Current Legal Problems 295, 309-313.

and ultimate end investors.[52] While this structure provides operational clarity and legal insulation, it complicates the purpose of stewardship by reinforcing a chain of accountability that stops short of addressing the broader interests of end investors or the systemic impacts of investment decisions.

When viewed through the lens of agency theory, this structural complexity is explained by reference to the dual role of institutional investors: acting as agents for their immediate clients/beneficiaries while simultaneously serving as principals in their interactions with company management. Gilson and Gordon have prominently described the resulting agency costs of intermediation as the "agency costs of agency capitalism", highlighting the challenges posed by misaligned incentives and conflicts of interests within the investment chain.[53]

However, significant differences exist between standard agency problems and those arising in delegated portfolio management, which the traditional principal-agent framework often struggles to address adequately.[54] Agency theory primarily focuses on power dynamics and addressing issues such as information asymmetry and monitoring inefficiencies. While it assumes that incentives and monitoring can resolve misalignments within the immediate relationship between principal-agent relationship, it struggles to account for the complexities of layered delegation and the mediation of third parties, such as proxy advisors.

For instance, asset managers, often tasked with executing stewardship activities on behalf of asset owners, such as pension funds or insurance companies, operate within a fragmented accountability structure. Asset owners may lack the capacity, expertise or incentives to closely oversee how stewardship is performed, yet they frequently rely on short-term financial performance metrics to evaluate the effectiveness of their asset managers.[55] This can create misaligned incentives, as asset managers' priorities may not always align with those of asset owners or, more critically, the ultimate end investors. These misalignments are further compounded by the high costs and resource demands of meaningful engagement, which can deter asset managers from pursuing meaningful stewardship.[56] Additionally, such a narrow

[52] John Morley, 'The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation' (2013) 123 Yale Law Journal 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.

[53] 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.

[54] See e.g. Andrew Ang, *Asset Management: A Systematic Approach to Factor Investing* (Oxford Academic, Oxford University Press 2014), 498.

[55] For example, the CFA's GIPS® Global Investment Performance Standards for Asset Owners 2020 specifically recommend quarterly investment valuations. See CFA Institute, *Global Investment Performance Standards (GIPS®) for Asset Owners* (2020).

[56] On resourcing, see FRC, The Influence of the UK Stewardship Code 2020, 19-27.

focus on financial performance and direct accountability within the investment chain often overlooks the systemic and societal dimensions of stewardship, such as addressing market-wide risks or contributing to environmental and social sustainability. This highlights a critical limitation of agency theory: its inability to adequately account for the broader responsibilities and complexities inherent in modern institutional investment.

The 1G UK Code did not remain silent on the challenge of balancing competing interests. The 2012 version explicitly acknowledged that stewardship extends beyond the interests of immediate clients and beneficiaries, aiming to "promote the long-term success of companies in such a way that the ultimate providers of capital also prosper".[57] Nevertheless, the Code left the balance between fulfilling the objectives of clients and beneficiaries and addressing broader interests, such as those of investee companies and end investors, largely implicit and underexplored. While a voluntary Code cannot override fiduciary, contractual or regulatory duties imposed on institutional investors, the lack of explicit guidance reinforced a transactional view of stewardship, one focused on immediate financial concerns and predominantly shareholder-centric—often equated with asset manager-centric—objectives. Moreover, it failed to resolve tensions between the mandatory obligations arising from fiduciary or regulatory duties and investment mandate, and the broader, long-term objectives envisioned by soft-law stewardship codes.

The Code's emphasis on micro-level shareholder engagement further entrenched this narrow perspective, framing stewardship primarily as a tool to address governance failures and short-termism within individual companies. This approach, centred on firm-level monitoring and engagement, reflected the dominant corporate governance priorities of the early 2010s. Even though the introduction of the 2G UK Code moved away from a narrow focus on institutional investors as micro-level shareholder monitors expanding stewardship at the macro- and systemic-levels, this shift also heightened the complexity of institutional investors' aspired roles, raising critical questions about how they can effectively balance competing priorities within an already fragmented and multi-layered investment chain.

These policy tensions, alongside differing interpretations of stewardship, structural complexities within the investment chain, and evolving expectations placed on institutional investors, highlight a lack of consensus on the fundamental purpose of stewardship. The next section addresses these ambiguities building on the analytical framework of enlightened stewardship.

[57] UK Code 2012, 1.

IV. Defining the Purpose of Stewardship: Balancing Client Objectives with the Interests of Unseen Others

Understanding the core purpose of shareholder stewardship requires moving beyond its practical manifestations—such as engagement and voting—and unpacking the underlying objectives it serves. At its essence, shareholder stewardship, though not a legal term, involves three key elements: *power, on behalf of others,* and *for others*.[58] It refers to the exercise of power by institutional investors to influence the conduct and outcomes of investee companies and, more broadly, the functioning of financial markets and the stability of society. This power is exercised *on behalf of others*—namely, the institutional investors' immediate clients and beneficiaries, such as asset owners, pension fund trustees, or insurers. However, stewardship extends beyond these direct relationships, as it is also exercised *for others* – a broader spectrum of stakeholders whose interests are indirectly affected by investment decisions. These include the ultimate providers of capital (e.g., pension fund members or insurance policyholders), the investee companies and their employees, society at large, the environment, and future generations.[59] Acting for others within the context of investor stewardship embodies a form of "self-actualizing" *trusteeship,* fostering benefits for both the steward and the broader stakeholders they serve.[60]

This expanded view encompasses multiple dimensions of responsibility, requiring institutional investors to balance immediate obligations with broader systemic and societal considerations. In another work, I have identified four distinct yet interconnected stewardship roles for asset managers that help navigate these complexities: *client stewardship, end-investor stewardship, asset stewardship* and *sustainability stewardship*.[61]

Client stewardship focuses on fulfilling the contractual and fiduciary obligations owed to immediate clients, such as asset owners, by ensuring adherence to the terms of the investment mandate. *End-investor stewardship* extends this responsibility, addressing the long-term financial and non-financial interests of the ultimate providers of capital, such as pension fund members or insurance policyholders. *Asset stewardship* emphasizes the responsible oversight of investee companies or other assets to enhance governance and financial performance. In the

[58] For a detailed analysis of this analytical framework, see Katelouzou , Unseen Others, 307-316.
[59] This element of responsibility and commitment to act not only on behalf of others but also for others is rooted in service rather than control, distinguishing a steward from a mere agent.
[60] But see Colin Mayer, 'Ownership, agency, and trusteeship: an assessment' (2020) 36 Oxford Review of Economic Policy 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').
[61] Katelouzou , Unseen Others, 316-322.

context of shareholder stewardship, this role, central to stewardship codes worldwide,[62] positions asset managers as active participants in corporate governance through engagement, voting and monitoring practices. Finally, *sustainability stewardship* aspires to address systemic risks and sustainability challenges, such as climate change, social inequality, and market-wide stability, broadening the scope of stewardship to consider the collective well-being of society and the environment. Unlike ESG stewards, who integrate environmental, social, and governance factors primarily to enhance financial outcomes, sustainability stewards – while still aiming for risk-adjusted returns – are prepared to tolerate short-term reductions in issuer market value and portfolio returns to achieve long-term societal impact.[63] Another distinction lies in their focus: ESG stewardship prioritizes mitigating negative externalities and protecting or enhancing asset (portfolio) value, whereas sustainability stewardship goes a step further by encouraging issuers to actively contribute to positive societal change, even in areas beyond their direct impact.

Together, these roles highlight the multifaceted nature of investor stewardship, illustrating its evolution from a narrow, shareholder-centric focus to a broader, more inclusive framework that incorporates "other-regarding" concerns.[64] At its heart lies the concept of *enlightened stewardship*, a vision that challenges institutional investors to act not solely on behalf of their immediate clients and beneficiaries but also in consideration of "unseen others", including end investors, investee assets, wider economy, environment, society, and future generations.[65] This expanded stewardship purpose presents a compelling but complex mandate, raising significant questions about how institutional investors can effectively balance these overlapping and sometimes competing priorities.

For instance, when asset owners delegate stewardship to asset managers who aspire to exercise stewardship in an enlightened way, the latter fundamentally act as client stewards, serving those who entrust them with funds within the parameters of the investment mandate and applicable regulatory frameworks. Under UK law, asset managers in this role owe common law duties of care and, under specific circumstances, fiduciary duties to their clients.[66] Beyond

[62] See Section II above.

[63] For empirical evidence of mixed motivations behind institutional investors' decisions to incorporate climate risk into their investment decisions, see Philipp Krueger, Zacharias Sautner and Laura T Starks, 'The Importance of Climate Risks for Institutional Investors' (2020) 33 The Review of Financial Studies 1067.

[64] However, it is crucial to distinguish between other-regarding 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.

[65] Katelouzou , Unseen Others, 321-322.

[66] See e.g. *Diamantides v JP Morgan Chase Bank* [2005] EWCA Civ 1612; FM Capital Partners Ltd v Marino and another [2018] EWHC 1768 (Comm) at [472]. See also The Law Commission, n 29 above paras. 3.17-3.24.

their client stewardship role, asset managers also bear responsibilities – albeit not under hard law – to the asset owner's clients and/or beneficiaries.[67] While the interests of clients/beneficiaries and end investors typically align, conflicts can still emerge. For instance, pension fund trustees might prioritize financial stability, low risk, and immediate liquidity to fulfil fiduciary obligations, whereas end investors could advocate for the integration of ESG considerations, even if they are not immediately material to financial returns or could increase short-term volatility.[68] Similarly, asset managers often face pressure to meet quarterly performance targets or maintain competitive fees, which may incentivize decisions that favour the short-term priorities of direct clients rather than the broader, long-term interests of end investors.[69]

These tensions become more pronounced as asset managers take on the role of asset stewards, focusing on the governance, performance, and sustainability of investee companies or other assets – a role shaped more by soft law and market expectations than by regulatory duties.[70] The challenges are especially evident in the context of micro-level shareholder stewardship. While well-performing assets ultimately benefit all stakeholders, the interests of individual assets may diverge from portfolio-level priorities. For instance, an asset manager may refrain from escalating engagement with a poorly performing company if divestment aligns better with portfolio-level optimization or risk management strategies. Similarly, engaging with a high-emission company to improve its environmental practices might conflict with short-term financial objectives or broader portfolio strategies prioritizing low-carbon investments.

These conflicting priorities underscore the difficulty of reconciling micro-level asset stewardship with macro-level portfolio and systemic objectives, particularly given the differing approaches of passive and active fund managers. Passive fund managers, constrained by their inability to divest from index constituents and operating under a lower-fee model, typically focus on portfolio-level engagement, seeking to improve practices across multiple companies simultaneously. In contrast, active fund managers may address these tensions by divesting from underperforming or non-compliant companies and reallocating resources to more targeted and assertive engagements. However, prioritizing the stewardship needs of a single asset risks

[67] Katelouzou , Unseen Others, 322-323.
[68] The Law Commission sought to reconcile this tension by clarifying that pension fund trustees may consider non-financial ESG factors if they have a reasonable belief that scheme members share these concerns, provided such consideration does not pose a significant risk of financial detriment to the fund. See The Law Commission, *Fiduciary Duties of Investment Intermediaries* (Law Com No 350, 2014), paras 5.63-5.76.
[69] See also note 55 above.
[70] Katelouzou , Unseen Others, 324-325.

diverting resources from addressing systemic risks or portfolio-wide concerns, potentially leading to under-engagement in other areas.

Moreover, the relative, rather than absolute, reward model commonly used in asset management diminishes the incentives for active fund managers to initiate firm-specific activist campaigns, a gap filled by activist hedge funds and other activist funds acting like them – the so-called activist shareholder stewards.[71] While active asset managers are likely to support hedge-fund-style activism when firm-level value maximization aligns with portfolio-level value maximization,[72] in all the other cases, conflict of interests arise between dedicating resources to stewarding an individual asset and maintaining a portfolio-level stewardship approach.

At the same time, an enlightened asset manager-steward is expected to not be overly sanguine about systemic social and environmental risks, which often necessitate action motivated by "values" rather than purely "value".[73] However, pursuing a sustainability stewardship role does not imply that an enlightened steward will always prioritize systemic factors over financial objectives or the immediate interests of clients and beneficiaries. Instead, enlightened stewardship requires a nuanced balancing exercise that recognizes the interplay between short- and medium-term financial goals and the long-term systemic risks that could ultimately undermine portfolio stability, market integrity, and societal well-being.

For example, addressing climate change may involve advocating for improved practices within high-emission companies, even if such actions temporarily reduce portfolio returns. Similarly, promoting social equity or supporting long-term governance reforms may appear misaligned with short-term financial metrics but could drive substantial benefits over the long run. An enlightened steward carefully weighs these competing priorities, ensuring that systemic considerations are not ignored but also not unilaterally imposed in ways that conflict with their fiduciary obligations or contractual mandates. Enlightened stewardship, therefore, is less about choosing one set of priorities over another and more about navigating a dynamic spectrum of interests to foster both financial resilience and broader societal impact.

This balancing exercise also raises critical questions about the role of stewardship codes in guiding institutional investors through these competing objectives. In this context, I have

[71] Katelouzou , The Rhetoric of Activist Shareholder Stewards, 707.

[72] Luca Enriques and Alessandro Romano, 'Rewiring Corporate Law for an Interconnected World' (2022) 64 Arizona Law Review 51, 55 (arguing that intermediary institutional investors are "portfolio value maximisers" rather than "firm value maximisers").

[73] On the difference between "values" and "value", see Laura T. Starks, 'Presidential Address: Sustainable Finance and ESG Issues—Value versus Values' (2023) 78 The Journal of Finance 1837.

argued in another work that stewardship codes can have a "crowding in" effect, institutionalizing *enlightened stewardship* which largely operates outside the domain of private law. While client stewardship is safeguarded by a complex mix of private law, non-mandatory stewardship codes can encourage "crowding in" of other-regarding stewardship behaviour – prompting institutional investors to extend their responsibilities beyond their immediate clients/beneficiaries to serve a broader range of "unseen others".[74] This crowding-in effect in relation to other-regarding stewardship arises not primarily from enforcement, which is inherently weak due to the soft-law nature of stewardship codes, but from their "expressive" or "preference-shaping" function.[75] By articulating a societal expectation that institutional investors will regard others beyond their clients/beneficiaries, stewardship codes can influence and shape investor behaviour more effectively by altering their internal preferences and perceptions of responsibility rather than by directly changing their external incentives.

In the UK, this crowding-in effect has been evident in both generations of the UK Stewardship Code. While the 1G UK Code, primarily emphasized micro-level shareholder engagement, focusing on corporate governance failures and short-termism, with a clear prioritization of asset stewardship at the firm-specific level, it emphasised that '[e]ffective stewardship benefits companies, investors and the economy *as a whole*'.[76] This emphasis reflects the diverse array of others (beyond their clients and/or beneficiaries) that institutional investors should consider in their capacity as stewards. The 2G UK Code reinforced this crowding in effect. In advancing systemic, market-wide and ESG stewardship, the 2G UK Code expands the notion of "others" beyond just end-investors and investable assets to encompass "the economy, the environment and society".[77]

Nevertheless, the crowding-in effect of the 2G UK Code remains incomplete, as other-regarding stewardship hinges on two critical factors: avoiding conflicts of interest and meeting materiality thresholds.[78] Regarding the first factor, the 2G UK Code seems to implicitly prioritize client stewardship by stipulating that other-regarding stewardship must not compromise the interests of client and/or beneficiaries. This is unsurprising, as soft law cannot override fiduciary, regulatory or contractual duties.[79] Consequently, while the Code

[74] Katelouzou , Unseen Others, 322-325.
[75] Margaret M. Stout Blair, Lynn A., 'Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law' (2000) 149 University of Pennsylvania Law Review 1735, 1744.
[76] Financial Reporting Council, UK Stewardship Code 2012 (London: FRC, 2012) (UK Code 2012) 1 (emphasis added).
[77] *ibid*, 4.
[78] Katelouzou , 322-325.
[79] See also above …

acknowledges the importance of sustainability stewardship, Principle 7 confines this within the realm of "material" ESG issues that serve the interests of clients and/or beneficiaries, including their investment time horizons. The ambiguity lies in whether the Code's materiality requirement extends beyond financial materiality – which assesses the impact of ESG factors on profitability and valuation – to include double materiality, which considers broader real-world societal and environmental impacts.[80]

Although the Code's expanded definition of stewardship and its emphasis on systemic risks suggest a broader perspective, its consistent reference to client and beneficiary interests supports financially material ESG stewardship (alpha enhancement) and stewardship addressing long-term systemic risks with financial relevance (beta enhancement). However, the 2G UK Code neither mandates nor explicitly excludes activities addressing "intrinsic materiality," which focuses on non-financial real-world outcomes.[81] The recently proposed revisions to the 2G UK Code by the FRC, including plans to remove references to "the environment and society" from its definition of stewardship,[82] further challenge the scope of enlightened stewardship. While this change reflects an increasing emphasis on client stewardship and a shift back toward a more calculated approach, aligning with fiduciary and other duties to clients and beneficiaries, it narrows the scope of the broader balancing act that enlightened stewardship entails. Specifically, this recalibration raises critical questions about the evolution of the UK's soft-law stewardship framework. Is it shifting too far toward client-centric models, thereby risking the erosion of its distinct crowding-in function as a soft-law, best-principles complement to mandatory investor duties? Or, can the framework adapt to reconcile these competing demands, enabling institutional investors to meet their hard-law obligations to immediate their clients/beneficiaries while also embracing their role as enlightened stewards?

V. Enlightened Stewardship and the Quest for A Shared Vision of Purpose

The tensions inherent in the enlightened stewardship framework invite a broader reflection on its alignment—or misalignment—with corporate purpose. While stewardship and corporate

[80] For pension trustees, see , paras 5.15 and 6.27. See also 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.

[81] 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.

[82] Financial Reporting Council, *UK Stewardship Code Consultation* (2024), para 19.

purpose share overlapping goals, it is important to distinguish the debates surrounding them. Unlike the corporate purpose discourse, which centres on the dichotomy between maximizing shareholder returns and serving broader stakeholder interests, stewardship introduces a distinct challenge: balancing the immediate interests of direct clients and beneficiaries with broader responsibilities to a wide range of stakeholders, including end investors, investee assets, society, the environment, and future generations.

This distinction underscores the complexity of stewardship: while corporations grapple with defining and implementing a purpose that reconciles profit with stakeholder impact, institutional investors face the dual challenge of honouring their fiduciary or other mandatory obligations while embracing a vision of enlightened stewardship that extends to corporate governance or even systemic and societal concerns. The unique priorities and responsibilities associated with each stewardship role – client, end-investor, asset, and sustainability stewardship – raise critical questions about how effectively stewards can navigate competing demands and act as a bridge between the immediate priorities of their clients/beneficiaries and the interests of wider stakeholders.

In this context, the other-regarding function of investor stewardship bears a striking resemblance to the trusteeship view of the board, which positions the board directors as custodians of the company's overall best interests.[83] Enlightened stewardship aligns closely with the shift toward a stakeholder-oriented corporate purpose, which asserts that companies bear responsibilities not only to their shareholders but also to a broader range of stakeholders, including employees, customers, communities, and the environment. However, at both the micro and macro levels, enlightened stewardship requires a delicate balancing exercise to navigate the competing demands of financial and societal objectives.

At the micro level, enlightened stewardship positions institutional investors as catalysts for change in corporate governance. By leveraging their voting power, engaging with management, and advocating for policies that align corporate goals with societal needs, investors can encourage companies to redefine their purpose to include commitments to sustainability, human rights, and responsible business practices. This role demands balancing short-term financial performance with long-term sustainability. Historically, the pursuit of shareholder value has driven an excessive focus on quarterly earnings, often at the expense of long-term planning. Enlightened stewardship directly supports a corporate purpose that

[83] See e.g. E. Merrick Jr. Dodd, 'For Whom are Corporate Managers Trustees' (1931) 45 Harvard Law Review 1145.

transcends short-term profit maximization. Its success, however, depends on the investor's ability to balance immediate financial priorities of clients/beneficiaries with broader, long-term objectives.

At the macro level, institutional investors can shape how companies within and beyond their portfolios balance profit-making with broader social and environmental concerns. For instance, an enlightened steward might champion policies to reduce carbon emissions, enhance workplace diversity, or improve supply chain transparency. However, this role hinges on a similar balancing act: institutional investors must weigh fiduciary obligations to their clients and beneficiaries against wider stakeholder interests.

Ultimately, the model of enlightened stewardship mirrors the enlightened shareholder value (ESV) codified in section 172 of the UK Companies Act 2006. Just as ESV encourages company directors to account for the impact of their decisions on various stakeholders to promote the company's long-term success, enlightened stewardship challenges institutional investors to consider a wider range of unseen others without undermining their fiduciary obligations. Nevertheless, a key distinction remains: company directors owe their duties directly to the company, whereas institutional investors manage assets on behalf of clients and beneficiaries. However, if stewardship accountability remains confined solely to clients and beneficiaries, it risks becoming redundant, adding nothing beyond the legal duties institutional investors already owe. For stewardship to be meaningful, it must explicitly acknowledge accountability to a wider range of stakeholders. To this end, I propose the following revised definition of stewardship for inclusion in the new UK Stewardship Code expected to be published in 2025:

> Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries, and *in doing so having regard to* sustainable benefits for broader stakeholders, including end investors, investable assets, the economy, environment, and society.

Compared to the current 2G UK Code definition – "*Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society*" – the proposed revision provides greater clarity on the primary purpose of stewardship. it explicitly states that the core objective is to deliver long-term returns for clients and beneficiaries, rather than *always* serving the interests of broader stakeholders – the unseen others. For some institutional investors, delivering sustainable benefits for broader stakeholders may align with the interests of their immediate clients/beneficiaries and can therefore be

incorporated into their investment objectives. However, stewardship should not be assumed to always equate to delivering broader benefits. The proposed definition acknowledges that while institutional investors must fulfil their duties to immediate clients/beneficiaries, they *have to regard to* the interests of a broader range of stakeholders. Importantly, the extent to which these broader interests are taken into account, and how institutional investors balance their different stewardship roles, remains at their discretion. This flexibility allows for adaptation to diverse investment strategies and objectives but underscores the need for clear guidance. The revised Code should provide accompanying explanatory notes to clarify what types of materiality—financial, double or intrinsic materiality—are relevant when considering broader stakeholders.[84] This guidance would help institutional investors navigate the complexities of balancing fiduciary duties with broader societal and environmental impacts, ensuring that stewardship remains both meaningful and practical.

By contrast, the FRC's proposed revised definition—*"Stewardship is the responsible allocation, management and oversight of capital to create long-term sustainable value for clients and beneficiaries"*—omits any explicit reference to broader stakeholders or systemic benefits.[85] This narrower scope risks perpetuating a purely client-centric stewardship model, potentially undermining the crowding-in function of the UK Stewardship Code, which is intended to complement hard-law investor duties. Without explicit reference to broader stakeholders, the question arises: what value does the UK Stewardship Code beyond enhancing transparency?

The 1G UK Code introduced micro-level shareholder engagement as a core objective, albeit with limited practical success in achieving tangible outcomes. The 2G UK Code expanded the scope of stewardship beyond shareholder engagement, incorporating environmental and social objectives into stewardship practices, and with a focus on tangible stewardship outcomes. However, without explicitly acknowledging the importance of broader stakeholder interests, the new Code risks failing short of establishing a crowding in principles-based framework to support existing investor duties. For e*nlightened* stewardship to fulfil its role, institutional investors must effectively balance the immediate interests of their clients and beneficiaries with the long-term welfare of end investors, investable assets, and broader societal and environmental impacts. An effective Stewardship Code should explicitly recognize these competing priorities, offering a principles-based framework that not only

[84] See also note 80 above.
[85] UK Stewardship Code Consultation, para 19.

aligns stewardship with fiduciary duties but also enables institutional investors to incorporate wider additional benefits into their investment. Only by doing so the Code can support an active market for stewardship and promote an enlightened vision of stewardship that supports long-term value creation for both investors and society.

VI. Conclusion

Enlightened stewardship is redefining the role of institutional investors in the 21st century, emphasizing the intricate balance between fulfilling fiduciary, regulatory, and contractual duties to immediate clients and beneficiaries, and addressing broader stakeholder interests, including end investors, investee assets, society, the environment, and future generations. For institutional investors with the ability and incentives to undertake micro-level shareholder stewardship, embedding an enlightened stewardship perspective into investment management positions them as pivotal actors in corporate governance. They can guide corporations toward a future where profit and purpose are mutually reinforcing.

Through a shared vision of purpose, shareholder stewardship evolves from a tool for monitoring and engaging at the firm-specific level into a catalyst for transformative change at both micro- and macro-levels, safeguarding the interests of both immediate clients/beneficiaries as well as wider stakeholders. Aligning stewardship purpose with the corporate purpose debate highlights the importance of meaningful collaboration between investors and companies. Both parties share a vested interest in long-term value creation, and enlightened stewardship provides a framework to integrate financial, social, and environmental sustainability into corporate and investment practices as long as these align with the immediate clients/beneficiaries priorities. This collaboration has the potential to establish a corporate governance model that harmonizes profit with purpose, ensuring that businesses and societies thrive together.

The role of stewardship at the macro- and system-levels requires further exploration, particularly in the context of passive investors, whose growing influence presents unique challenges and opportunities. Institutional investors, whether active or passive, must navigate complex and often conflicting priorities, balancing their obligations to clients/beneficiaries with a wider range of unseen others, including systemic challenges such as climate change, inequality, and market stability. By effectively balancing these broader considerations—while accounting for differences in investment management models, time horizons, and strategies—

enlightened stewardship can empower both active and passive investors to contribute meaningfully to long-term sustainable value.

A purposeful UK Stewardship Code that reflects this vision can set a global benchmark for enlightened stewardship. By systematically integrating stakeholder interests into investment practices, such a code would advance the corporate purpose debate, fostering inclusive and sustainable models where financial success supports societal and environmental progress. By inspiring global leadership in integrating the interests of unseen others into stewardship practices—without compromising the primacy of clients and beneficiaries—it can establish a new standard for how institutional investors contribute to building a better, more sustainable future.

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