From Shareholder Stewardship to Shareholder Duties: Is the Time Ripe?

Iris H-Y Chiu* and Dionysia Katelouzou**

In the context of the increasing institutionalisation of the global equity this chapter examines the development of the soft law of shareholder stewardship originating in the UK Stewardship Code and provides insights into its prospective evolution into hard law standards of behaviour for institutional shareholders. We argue that the time is ripe for the development of shareholder duties on the part of institutional investors. We contend that the proposed Shareholder Rights Directive 2014 is already taking a step towards that direction by introducing a semi-hard law of a fiduciary duty to demonstrate engagement at a pan-European level. We argue that such a duty is relevant to different European jurisdictions; even if ownership structures are still rather different across the EU there is a shifting balance between traditional blockholders, such as families, and institutional investors.

I. Introduction

Recent years have seen the creation of a soft law notion of 'stewardship' to define the institutions' and asset managers' responsibilities towards their investee companies in response to a perceived need for curtailing short-term investment behaviour. Institutional investors have become powerful and influential players at a national, European and a global level and have a tremendous capacity to affect the attractiveness and stability of capital markets. This institutionalisation of corporate ownership took place not only in 'outsider/arm's-length'[1] countries such as the UK,[2] but also in 'insider/control-oriented' countries, such as Germany,[3] which were until recently dominated by blockholders, such as families, the state or banks.[4] With the majority of equity currently held by institutional investors, especially alternative investment funds, many commentators argued that institutional investors could bridge the monitoring gap between beneficial owners and corporate managers.[5] Others are more concerned with the ability of institutional investors to

[1] For the distinction between 'outsider/arm's length' and 'insider/control-oriented' systems of corporate governance, see Erik Berglöf, 'A Note on the Typology of Financial Systems' in Klaus J. Hopt and Eddy Wymeersch (eds.), Comparative Corporate Governance: Essays and Materials (1997)

[2] Brian C. Cheffins, Corporate Ownership and Control: British Business Transformed (Oxford: Oxford University Press), 344-6.

[3] G Ringe, 'Changing Law and Ownership Patterns in Germany: Corporate Governance and the Erosion of Deutchland AG' (2015) 63 American Journal of Comparative Law 493.

[4] On ownership patterns see Marco Becht and Colin Mayer, 'Introduction' in Fabrizio Barca and Marco Becht (eds), The Control of Corporate Europe (Oxford: Oxford University Press, 2001).

[5] See eg Bernard Black (1992) 'Agents Watching Agents: The Promise of Institutional Investor Voice' 39 UCLA Law Review 811.

influence companies at their own benefit.[6] At the same time, there is a broad agreement that institutional investors, and especially activist hedge funds, often undertake a short-termist outlook which needs to be addressed.[7]

In response to these concerns, the law of stewardship has been introduced in several jurisdictions to promote governance obligations of stewardship and sustainable engagement upon institutional investors. The law of stewardship originates in the UK Stewardship Code,[8] which was introduced in the UK in 2010 as a "soft law" Code of best practices for institutions and asset managers in conducting their relationships with their investee companies.

Much has been written about the rise of the soft law of corporate governance, as a response to the challenges in governing global business and corporations.[9] Today's business and corporations operate at a transnational level, transcending state boundaries and state-backed law, engaging in regulatory arbitrage as well as in the perpetuation of self-governance systems. Against this backdrop, familiar notions of sovereign power, state-backed governance, hard law as a staple instrument of regulation, and the "public-private" divide[10] are being challenged by soft law principles and norms. The emergence of corporate governance codes, [11] a form of soft law that has developed out of the interactions of policy-makers, stock exchanges, business and the investor community, is an example of this market-oriented, indirect regulatory approach.

The creation of a soft law notion of "stewardship" to define institutions' and asset managers' responsibilities is part of this emerging market-oriented governance landscape. The introduction of the UK Stewardship Code reflects the long history of the deference of UK policy-makers to "market-invoking" regulation, especially in the financial services sector.[12] This means that regulators are keen to institute regulatory orders that also involve market discipline, moving away from traditional top-down or command-and-control positions. Such indirect regulatory approaches may be regarded as a hallmark of the "post-regulatory state"[13] and are part of a larger global change in the regulatory landscape of corporate and financial regulation in the last decades.

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[6] See eg I Anabtawi and Lynn A Stout (2008) 'Fiduciary Duties for Activist Shareholders' 60 Stanford Law Review 1255.

[7] Simon Walker *Short-termism is a wolf stalking the equity market* The Telegraph 13 November 2014

[8] Financial Reporting Council (FRC), The UK Stewardship Code 2010, 2012, see https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx.

[9] Peer Zumbansen, 'Neither 'Public' nor 'Private', 'National' nor 'International': Transnational Corporate Governance from a Legal Pluralist Perspective' (2011) 38 Journal of Law and Society 50; Larry Catá Backer, 'Private Actors and Public Governance Beyond the State: The Multinational Corporation, the Financial Stability Board and the Global Governance Order' (2011) 18 Indiana Journal of Global Legal Studies 751.

[10] John Braithwaite and Peter Drahos, *Global Business Regulation* (Cambridge: CUP 2008) at chapters 23-26.

[11] Alessandro Zattoni and Francesca Cuomo, 'Why Adopt Codes of Good Governance? A Comparison of Institutional and Efficiency Perspectives' (2008) 16 Corporate Governance: An International Review 1; Klaus J Hopt, 'Comparative Corporate Governance: The State of the Art and International Regulation' (2011) 59 American Journal of Comparative Law 1; although see Carsten Gerner-Beuerle, 'Determinants of Corporate Governance Codes' (2014) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2346673 for a more nuanced assessment of the internationalisation of corporate governance codes.

[12] Mark Moore, *Corporate Governance in the Shadow of the State* (Oxford, Hart 2013).

[13] On the development of soft law and private ordering in corporate governance, see further Gralf-Peter Calliess and Peer Zumbansen, *Rough Consensus and Running Code: A Theory of Transnational Private Law* (Oxford and Portland, Oregon: Hart Publishing 2012), at chapter 4.

However, this soft law approach in corporate governance has not escaped revisitation in the light of the global financial crisis of 2007-8, and has been considerably tightened in post-crisis reforms. The recent EU Commission's proposals in relation to shareholder engagement in the proposed Shareholder Rights Directive[14] is a step towards that direction. This Chapter argues that the proposed Directive introduces a duty to *demonstrate* engagement on the part of institutional investors and asset managers, and is, therefore, a tentative step towards hardening of stewardship duties at a pan-European level. Although this is not an expressly defined duty we expect that the public policy reasons that drive such harmonisation will develop in due course notions of defined institutional shareholder duties. We also argue that such a duty is relevant to different European jurisdictions despite any differences in the ownership structures. For jurisdictions with dispersed ownership structures like the UK where the main concern is with shareholder apathy, such a duty seeks to encourage more monitoring and engagement. For jurisdictions with traditionally concentrated ownership structures which are now experiencing investment inflows of foreign institutional minority shareholders, such a duty is able to introduce more clarity into the expectations for shareholder conduct and intra-shareholder relations.

II. The Soft Law of Shareholder Stewardship – the Origins and Drivers of Development

Shareholder stewardship is a term coined in the UK to refer to constructive shareholder engagement and monitoring of investee companies, in order to overcome the agency problems between institutional shareholders and corporate directors.[15] In the wake of the UK banking crisis 2008/9, institutional shareholders were accused to have been "asleep",[16] being too uncritical of risky business practices in their investee banks and neglecting to monitor Board risk management. Although institutional shareholder apathy is not regarded as the key cause of the UK banking crisis,[17] the Walker Review[18] on corporate governance in banks and financial institutions was of the view that such institutional shareholder apathy has provided a tolerant context for misjudgements of risk made at the Board level of the failed UK banks.

[14] Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement (SWD(2014) 126,127,128 final) published 9 April 2014 (hereinafter 'proposed Shareholder Rights Directive'), Parliament amended version of 8 July 2015 at http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P8-TA-2015-0257+0+DOC+XML+V0//EN.

[15] See Iris H-Y Chiu, 'Turning Institutional Investors into 'Stewards'- Exploring the Meaning and Objectives in 'Stewardship'' (2013) Current Legal Problems 1. Note, however, that with equity held by investment intermediaries an additional agency problem between individual investors and intermediary institutions emerges. On this dual set of agency relationship, see Ronald J Gilson and Jeffrey N. Gordon, 'The Agency Costs of Agency Capitalism: Activist Investors and Reevaluation of Governance Rights' 113 *Columbia Law Review* 863.

[16] 'FSA Chief Lambasts Uncritical Investors', *Financial Times* (11 March 2009) and 'Myners Lashes out at Landlord Institutional shareholders', *Financial Times* (21 Apr 2009). Also 'Institutional Institutional shareholders Admit Oversight Failure on Banks', *The Daily Telegraph* (27 Jan 2009).

[17] Jonathan Mukwiri and Matthias Siems, 'The Financial Crisis: A Reason to Improve Shareholder Protection in the EU?', Paper presented at the Leeds Law School Conference (6 Dec 2012).

[18] David Walker, *A Review of Corporate Governance in Banks and Financial Institutions* (Nov 2009).

The UK banking and global financial crisis has provided an opportunity for reflections upon corporate and investment culture, and the role of institutional investors in fostering general economic and social well-being. Policy makers were of the view that, although the banking crisis was directly attributed to poor management decisions and risk culture, shareholder apathy played a role in leaving management unchecked.[19] Subsequently, the Kay Review of Equity Markets pointed out the much-needed role of constructive shareholder engagement for long-term wealth creation in the corporate sector.[20]

Within this background the notion "stewardship" has been articulated and developed in the UK to encourage institutional shareholders to move away from apathy and to engage with investee companies. The UK Stewardship Code[21] was promulgated by the Financial Reporting Council in 2010 and revised in 2012 and 2014 as a "soft law" Code of best practices for institutions and asset managers in conducting their relationships with their investee companies. The Code evolved out of the Institutional Shareholders' Committee's similarly-named Code of 2010,[22] and therefore accords with market perceptions of the appropriate role for institutional investors. The Code is not mandatory, but voluntary signatories to the Code should comply or else explain[23] why they do not comply with the Code's principles. The Code has attracted 302 voluntary signatories[24] to date, including all major UK and international institutions, asset managers and proxy advisory agencies.

Under the UK Stewardship Code, stewardship involves "monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration" through voting and the development of a "purposeful dialogue" with the investee companies on these matters.[25] The UK Stewardship Code therefore provides a means of legitimation for the acceptable forms of shareholder engagement which would be treated as stewardship. In this way, the form of contemporary shareholder activism carried out by hedge-funds,[26] which is regarded with some scepticism in the UK and Continental Europe, may have to conform to the standards in the Code.

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[19] Jennifer Hughes, 'FSA Chief Lambasts Uncritical Investors' *Financial Times* (London, 11 March 2009); Kate Burgess, 'Myners Lashes out at Landlord Institutional shareholders' *Financial Times* (London, 21 April 2009). Also Helia Ebrahimi, 'Institutional Shareholders Admit Oversight Failure on Banks' *The Daily Telegraph* (London, 27 January 2009); European Commission, 'Green Paper on The EU Corporate Governance Framework' COM(2011) 164 final, para 2.

[20] BIS, *The Kay Review of UK Equity Markets and Long-Term Decision Making* (Final Report, 23 July 2012).

[21] The Code is administered by the Financial Reporting Council, see https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx.

[22] The Institutional Shareholders' Committee's Stewardship Code 2010 was established after the Walker Review of Corporate Governance in Banks and Financial Institutions criticised institutional shareholders for apathy and lack of monitoring, see para 5.7, David Walker, 'A Review of Corporate Governance in UK Banks and other Financial industry Entities: Final Recommendations' (26 November 2009) http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf (Walker Review 2009).

[23] On the comply or explain approach, see further John G Parkinson and G Kelly, 'The Combined Code of Corporate Governance' (1999) The Political Quarterly 101.

[24] These include: 203 asset manager signatories, 86 asset owners and 13 proxy advisory agencies.

[25] UK Stewardship Code, pg.1.

[26] Brian R Cheffins and John Armour, 'The Past, Present and Future of Shareholder Activism by Hedge Funds' (2012) 37 Journal of Corporation Law 51; Dionysia Katelouzou, 'Myths and Realities of Hedge Fund Activism: Some Empirical Evidence' (2013) 7 Virginia Business and Law Review 459.

Upon its introduction commentators criticised the UK Stewardship Code for being national in character and unlikely to appeal to foreign investors who own the bulk of UK corporate equity.[27] However, the Code has since taken its place in the transnational governance space and inspired international developments in the institution of Stewardship Codes in many other countries, including the Netherlands, Switzerland, Japan and Malaysia.[28]

We are of the view that the gradual internationalisation of the Code shows its flexibility in dealing with different corporate governance systems and contexts of ownership structures. The gradual internationalisation of soft law governance obligations of stewardship on the basis of the UK Stewardship Code is likely to be driven by the common concerns shared by many jurisdictions with listed markets in relation to the role of institutional investors in their markets. In the last two decades we have started to witness the rise of collective investment funds as major investors in global corporate equity. These include the institutional funds of the US and Europe, sovereign and private wealth funds managed in-house or by global banks and investment institutions,[29] and alternative investment funds such as hedge funds.[30] The rise of funds as significant global corporate equity owners,[31] even in businesses featuring concentrated and closely-knit majority ownership, has produced an undeniable impact upon the global governance of business.

The growth of institutional ownership may be characterised as a form of financialisation of corporate finance, bringing the centricity of shareholder value as a corporate objective to the fore.[32] The absorption of the shareholder-centric model into global corporate governance has

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[27] Brian R Cheffins, 'The Stewardship Code's Achilles Heel' (2010) 73 Modern Law Review 1004.

[28] Discussed in Iris H-Y Chiu, 'Learning from the UK in the Proposed Shareholders' Rights Directive 2014? European Corporate Governance Regulation from a UK Perspective' (2015) 114 ZVgIRWiss forthcoming. See also Simon Wong, 'Is Institutional Investor Stewardship Still Elusive' (2015) Buttleworths Journal of International banking and Financial law, 508, also available at http://ssrn.com/abstract=2654229

[29] The OECD reports that growth in collective investment management has been remarkable since the early 1990s, see John K Thompson and Sang-Mok Choi, 'Governance Systems for Collective Investment Schemes in OECD Countries' OECD Occasional Paper (April 2001). The Price Waterhouse Coopers survey of Asset Management reports that global assets under management stand at about USD$64 trillion at end of 2013, see PwC, *Asset Management 2020: A Brave New World* (2013) at http://www.pwc.com/gx/en/asset-management/publications/asset-management-2020-a-brave-new-world.jhtml. That relates to assets managed by professional asset managers and does not include those managed in-house. In terms of pensions, as of 2012, total assets under collective management in global pensions (where data has been available) stand at approximately USD$30 trillion, total assets managed by insurance companies at approximately USD$24 trillion and total assets managed by other investment funds at approximately USD$22 trillion, http://www.oecd.org/finance/private-pensions/globalpensionstatistics.htm. In Europe, assets under management, including pensions, stand at 13.8 trillion euros at the end of 2011, see EFAMA, *Asset Management in Europe: 6th Annual Review* (2013) at http://www.efama.org/Publications/Statistics/Asset%20Management%20Report/Asset_Management_Report_2013.pdf. Haldane estimates in 2014 a figure of total global assets managed by insurance companies, pension funds, mutual funds and others as representing about twice the size of global gross domestic product, see Andy Haldane's speech estimating global assets managed by institutions to be at USD$87 trillion, at http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech723.pdf.

[30] Alternative investment fund assets are estimated to stand at more than USD$2 trillion, based on Deutsche Bank's *2014 Alternative Investment Survey* at https://www.db.com/medien/en/content/4666_4819.htm. See Gordon L Clark and Darius Wójcik, *The Geography of Finance* (Oxford: OUP, 2007) at chapters 2, 6 and 7.

[31] See eg Ringe above note 3.

[32] Paddy Ireland, 'The Financialization of Corporate Governance' (2009) 60 Northern Ireland Legal Quarterly 1; Engelbert Stockhammer, 'Financialization and the Slowdown of Accumulation' in Ismail Erturk,

been gradual but marked.[33] Globally competitive stock exchanges and securities regulators have in response fashioned corporate governance standards as part of securities regulation in the regulatory competition for listings and institutional investment.[34] The increased fund ownership of worldwide corporate equity accompanied with the potential of funds' corporate governance positions to affect the structures and practices in national corporate sectors have thus given rise to questions about the funds' role and influence such as: What is the governance role of investment funds? How should their governance roles be cast? And, how should their governance roles be governed?

Institutional funds have prior to the 1990s earned a reputation for being passive and for being negligible in their corporate governance roles.[35] However, since then, a form of 'defensive' shareholder activism has developed in the US. 'Defensive activism' occurs when a shareholder (not only an institutional one) with a pre-existing stake in a company seeks to rectify managerial failures promoting changes which are largely related to issues of governance in the company and could improve long-term investment.[36] Institutions in the UK have been slower to take up activist stances against their investee companies but informal engagement has been observed on an ad hoc basis.[37] In the 2000s, new forms of shareholder activism have begun to emerge in the US, led by activist hedge funds that use shareholder activism as a form of investment management strategy.[38] The style of shareholder activism in which hedge funds engage presupposes an equity stake as the departure point which is accumulated *proactively*; that is activist hedge funds either do not have a pre–existing stake in the target company or they have a small one which they quickly increase when they decide to adopt a hands–on strategy.[39] Activist hedge funds target companies for the purposes of 'value extraction', campaigning for certain measures to be taken, such as sale of assets, sale of business, share buybacks or distribution of dividends, in order to 'unlock' value from the company.[40] Such funds may also make demands for governance improvements but it is less certain if governance concerns are indeed relevant to the value extraction agenda.[41] Although

Julie Froud, Sukhdev Johal, Adam Leaver and Karel Williams (eds), *Financialization At Work: Key Tests and Commentary* (Oxford: Routledge, 2008).

[33] Roger M Barker, *Corporate Governance, Competition, and Political Parties: Explaining Corporate Governance Change in Europe* (Oxford: OUP 2010); Laura Horn, 'Corporate Governance in Crisis? The Politics of EU Corporate Governance Regulation' (2012) 18 European Law Journal 83.

[34] Mathias Siems, 'Convergence in Corporate Governance: A Leximetric Approach' (2010) 35 Journal of Corporation Law 729; Gerner-Beuerle, above note 12.

[35] Bernard S Black, 'Shareholder Passivity Re-examined' (1990) 89 Michigan Law Review 520; John Hendry, Paul Sanderson, Richard Barker and John D Roberts, 'Owners or Traders? Conceptualizations of Institutional Investors and Their Relationship with Corporate Managers' (2006) 59 Human Relations 1101.

[36] Michael P Smith, 'Shareholder Activism by Institutional Investors: Evidence from CalPERS' (1996) 51 Journal of Finance 227, Iris H-Y Chiu, *The Foundations and Anatomy of Shareholder Activism* (Oxford: Hart Publishing 2010), Chapters 1 and 2.

[37] Bernard S Black and John C Coffee, 'Institutional Investor Behaviour in the UK' (1993-4) 92 Michigan Law Rev 1999.

[38] Chiu, above note 37, chapter 3; Brian R Cheffins and John Armour, 'The Past, Present and Future of Shareholder Activism by Hedge Funds' (2012) 37 Journal of Corporation Law 51.

[39] Katelouzou, above note 27.

[40] William W Bratton, 'Hedge Funds and Governance Targets' (2007) 95 Georgetown Law Journal 1375; Nicole M Boyson and Robert Mooradian, 'Corporate Governance and Hedge Fund Activism' (2011) 14 Review of Derivatives Research 169; Lucian A Bebchuk, Alon Brav and Wei Jiang, 'The Long-Term Effects of Hedge Fund Activism' (2014) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2291577; (2015) Columbia Law Review (forthcoming);.

[41] Michael Schor and Robin Greenwood, 'Investor Activism and Takeovers' (2009) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1003792; Yvan Allaire and Francois Dauphin, ''Activist' Hedge Funds: Creators of Lasting Wealth? What Do the Empirical Studies Really Say?' (2014) at

hedge fund activism emerged in the US, it quickly spread to other countries in Europe and Asia, but not as duplicates of the American practice.[42] Significant blockholdings by families, banks, and the state, which are more prevalent in Continental Europe, do not guarantee that activist hedge funds will stay away.[43] At the same time, mainstream institutional investors, such as pension funds and mutual funds, are increasingly becoming "rational reticent", i.e. they are increasingly willing to respond to proposals placed by activist investors even if they do not initiate such proposals themselves.[44]

As shareholder activism is now on the rise in the US, and growing in the UK, Continental Europe, and Asia there is arguably a case for considering if such engagement should be subject to a regulatory framework. Whether in jurisdictions with dispersed ownership structures such as in the UK or jurisdictions with traditionally concentrated ownership such as in much of Continental Europe, minority shareholder activism, led by mainstream and alternative institutions, whether of the defensive or offensive types described above have become relevant matters of concern. Such activism leverages upon existing shareholder rights in domestic company law frameworks throughout the world and is supported by a shareholder primacy rhetoric.

The shareholder primacy rhetoric in corporate law began life in economic terms – it is as a result of the efficient organisation of the company,[45] and it is not a political phenomenon. However, the rise of institutional investors due to the privatisation of pensions saving has gradually shaped shareholder primacy into a political phenomenon – a phenomenon of the legitimacy of exercise of powers.[46] The increasing influence and power that institutions wield against their investee companies may be socially controversial[47] and provides a context for us to consider if their engagement should be subject to a regulatory framework. Further, the flipside of shareholder activism, especially of the offensive variant,[48] is also an important governance issue.

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http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2460920; Yvan Allaire and Mihaela E Firsirotu, 'Hedge Funds as Activist Shareholders: Passing Phenomenon or Grave-Diggers of Public Corporations?' (2007) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=961828.

[42] On hedge fund activism outside the US, see John Buchanan, Dominic Heesing Chai and Simon Deakin, *Hedge Fund Activism in Japan: The Limits of Shareholder Primacy* (Cambridge: CUP 2014).; Katelouzou, above note 27; Dionysia Katelouzou, 'Worldwide Hedge Fund Activism' Dimensions and Legal Determinants' (2015) 17 University of Pennsylvania Law Review 789; Alexandros Seretakis, 'Hedge Fund Activism Coming to Europe? Lessons from the American Experience' (2014) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2380852.

[43] Consider, for instance, the activist intervention of the TCI in Airbus. Hugh Carnegy, Hedge Fund puts EADS chief's boast to the test, Financial Times, 10 August 2013.

[44] Gilson and Gordon, above note 16.

[45] Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law* at chapter generally; Jill Fisch, 'Measuring Efficiency In Corporate Law: The Role of Shareholder Primacy' (2005) 31 Journal of Corporation Law 637.

[46] See Henry Hansmann and Reiner Kraakman, 'The End of History in Corporate Law' (2000) 89 Georgetown Law Review 439; Martin Gelter, 'The Pension System and the Rise of Shareholder Primacy' (2013) 43 Seton Hall Law Review 910. In the UK, Armour et al argue that shareholder primacy is a powerful norm but somewhat mitigated by Europe's pro-stakeholder agendas, see John Armour, Simon Deakin and Suzanne Konzelmann, 'Shareholder Primacy and the Trajectory of UK Corporate Governance' (2003) 41 British Journal of Industrial Relations 531.

[47] See for example, 'Shareholder power 'holding back economic growth', *BBCNews* (based on an interview carried out by the BBC with Andrew Haldane, Chief Economist, Bank of England, 24 July 2015).

[48] See for example April Klein and E Zur, 'The Impact of Hedge Fund Activism on the Target Firm's Existing Bondholders' (2011) 24 The Review of Financial Studies 1735.

As global business and corporations have challenged traditional forms of state-based governance and traditional legal instruments and enforcement, the mobilisation of various financial actors with governance potential in the de-centred regulatory landscape[49] is arguably important to hold transnational businesses to account. It is within this context that the notion of shareholder stewardship has been developed in the UK to promote institutional investors to take on corporate governance roles as a part of the mosaic of the governance of global business in the transnational environment in which they operate. The soft law of shareholder stewardship has been further internationalised to address the need for constructive engagement by institutional investors for the purposes of supporting a long-term wealth-creating corporate sector and mitigating short-termism and trading-focused investment management, and the need to define the terms of engagement in order to rein in opportunistic activist behaviour.

III. Shareholder Engagement under the EU Commission's Proposed Shareholder Rights Directive 2014

The EU is taking steps to forge shareholder engagement norms into hard law as part of legal integration.[50] In April 2014 the European Commission proposed several amendments to the Shareholders' Rights Directive including the introduction of an engagement policy for all institutions and a form of disclosure-based regulation of institutions' investment policies and strategies, their arrangements with asset managers, and the accountability of asset managers to institutions.[51] This Chapter focuses only on the shareholder engagement provisions in the Directive and is based on the text as amended by Parliament in July 2015 which introduced further amendments to the Commission's provisions.

Article 3f of the proposed Shareholder Rights Directive provides that Member States shall require institutional investors and asset managers to develop an engagement policy, which would state, inter alia, how institutional investors and asset managers intend to integrate shareholder engagement in their investment strategy, monitor their investee companies' performance, exercise their voting rights, use proxy advisors' services, and cooperate with other shareholders. Further Article 3f makes it mandatory that the engagement policy will address issues of management of conflicts of interest. Institutions are required to publicly disclose the engagement policy, how it is implemented and the results achieved. If they decide not to institute an engagement policy or to disclose the matters above, they need to provide a reasoned explanation for doing so.

Under the proposed Shareholder Rights Directive institutional investors should also annually disclose to the public their investment strategies and explain how such strategies are aligned with the duration of their liabilities and with the medium to long term performance of

[49] Colin Scott, 'Analysing Regulatory Space: Fragmented Resources and Institutional Design' (2001) Public Law 329; 'Reflexive Governance, Meta-regulation and CSR' in Nina Boeger, Rachel Murray and Charlotte Villiers (eds), *Perspectives on Corporate Social Responsibility* (Cheltenham: Edward Elgar 2008), at chapter 9.

[50] Legal integration is used extensively as a market-building tool, see Eilis Ferran, *Building an EU Securities Market* (Cambridge: CUP 2004).

[51] Proposal Shareholder Rights Directive, Arts 3f to 3h.

their assets.[52] Additionally, the proposed Directive imposes disclosure obligations on asset managers, who must disclose on a half-yearly basis to their institutional clients how their investment strategies and policies intend to meet their clients' investment objectives and duration of liabilities,[53] and on proxy voting advisors.[54]

The requirement in Article 3f which relates to the institution of an engagement policy on the part of institutional investors and asset managers, is similar to Principle 1 of the UK Stewardship Code that requires UK institutions to develop a stewardship policy. The UK Stewardship Code however binds only voluntary signatories, while the Directive is intended for application to all institutions in the EU.

The matters that may be stated in the engagement policy relate to how institutions:

(a) integrate shareholder engagement in their investment strategy;

(b) monitor investee companies, including on their non-financial performance and the reduction of social and environmental risks;

(c) conduct dialogues with investee companies;

(d) exercise voting rights;

(e) use services provided by proxy advisors;

(f) cooperate with other shareholders;

(fa) to conduct dialogue and cooperate with other stakeholders of the investee companies.

Other than (e), (fa)[55] and some aspects of (b) above, the matters in mandatory engagement policies are consonant with the Principles in the UK Stewardship Code.[56] The Code is very much premised on the acceptance that an active corporate governance role for institutions will be aligned with their interest in the investment performance of their portfolio companies.[57] Further, (b) is reflected in Principle 3 of the Code that requires institutions to monitor their investee companies. The acts of "monitoring" are further developed in the UK

[52] In particular, if institutions appoint asset managers, institutions must disclose as to how such arrangements would meet their objectives, their policies and strategies in evaluating asset managers and portfolio turnover, the duration of the appointment and how the agreed performance yardsticks and asset management charges and fees accord with their objectives. See Proposed Shareholder Rights Directive, Art. 3g.

[53] Proposed Shareholder Rights Directive, Art. 3h.

[54] Proposed Shareholder Rights Directive, Art. 3i.

[55] Inserted as amendments by Parliament to the Commission's original proposal.

[56] Financial Reporting Council, *UK Stewardship Code 2014* at https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx.

[57] Although empirical literature is not so clear on the link between shareholder activism and performance, see Sunil Wahal, 'Pension Fund Activism and Firm Performance' (1996) 31 Journal of Financial and Quantitative Analysis 1; Jonathan M Karpoff, 'The Impact of Shareholder Activism in Target Companies: A Survey of Empirical Findings' (Sep 2001) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=885365, although hedge fund activism and its unique features may constitute a different paradigm for investigation altogether, see see Alon Brav, Wei Jiang, Frank Partnoy and Randall Thomas, 'Hedge Fund Activism, Corporate Governance, and Firm Performance' (2009) 63 The Journal of Finance 1729-1775; Marco Becht, Julian Franks, Jeremy Grant and Wagner Hannes, 'The Returns to Hedge Fund Activism: An International Study' ECGI Finance Working Paper No. 402 (2014).

Stewardship Code, including being adequately informed about their portfolio companies. In this way, the Code may provide some input into how the proposed Directive may be interpreted. Subsection (c) relates to Principle 4 of the UK Stewardship Code which envisages escalation activities as part of active ownership where necessary; such escalation activities include holding dialogues with portfolio companies, such as with the Senior Independent Director of the Board.

Subsection (d) of Article 3f is reflected in Principle 6 of the UK Stewardship Code which requires institutions to disclose their voting policies. One may argue that the proposed directive goes further than its UK counterpart as it requires the exercise of voting rights to be part of the engagement policy, and not merely the formulation of a voting policy and its due disclosure, as is required under the UK Stewardship Code. Finally, (f) is reflected in the UK Stewardship Code's welcoming stance on collective engagement. Again, one may make a distinction between the two as (f) refers to co-operation and this may be wider than that captured in the Code's collective engagement paradigm. Collective engagement refers to joint activism by institutions in times of corporate stress or wider economic stress, and is thus premised upon the protection of collective economic interests in investment, while co-operation can take place in financially healthy times.

IV. Hardening the Norms of Shareholder Stewardship?

A. Towards a duty to demonstrate engagement on grounds of public long-termist interests

On its face, the proposed Directive does not introduce a duty to engage for institutions as such, as Article 3f allows a comply-or-explain approach, i.e. institutions should comply with the practice of developing an engagement policy as outlined in the Article, but if they choose not to, they should explain as to how the lack of an engagement policy would still enable them to achieve their objectives. This is similar to the UK Stewardship Code's comply-or-explain approach. If one regards the comply-or-explain approach taken by the proposed Directive, it seems that the development of an engagement policy on the part of institutions remains soft law. It is, however, rather anomalous to uphold soft law in the wrapper of a legislative text. We are of the view, therefore, that the proposed Directive demonstrates a normative expectation that shareholder engagement is part and parcel of investment management by institutions.

Although an institution can clearly reject an engagement strategy and instead explain the irrelevance of shareholder engagement in its policy, the proposed Directive is not far short of imposing a *duty to demonstrate engagement*, as there is a duty to publicly disclose the implementation and achievement of such engagement under Article 3g. Further, the duty to publicly disclose includes disclosure of how institutions ensure that their asset managers achieve their investment mandates, including via the means of shareholder engagement. Arguably the disclosure-based regulation compels that certain engagement conduct needs to

be carried out in order for there to be sufficient matters to report. This is a move away from treating shareholder engagement as a voluntary practice, as is the case under the UK Stewardship Code, to which voluntary signatories adhere.[58] This is arguably a step towards hardening stewardship norms into an engagement behaviour that is transparent and accountable, balancing a range of interests which are long-termist in nature. These behavioural norms on the part of institutions are seen to be in the public interest and reflecting the social expectations of constructive shareholder behaviour.

The amendment of Article 3f by the European Parliament in July 2015 further supports such a hardening of stewardship expectations.[59] In particular, Article 3f was amended by the European Parliament to shape the engagement policy towards non-financial performance and the reduction of social and environmental risks, and to compel institutions to engage with stakeholders in their engagement policies. This would likely reflect a broad-based public interest in making institutional shareholders accountable for broader concerns in respect of companies' operations and to wider constituents in the exercise of their engagement powers. This is certainly contrary to the position in the UK. First, the UK regards companies and their management as being responsible for reporting on stakeholder relations and corporate responsibility footprints.[60] Shareholders are regarded as "enlightened"[61] and ought to be interested monitors of such issues, but requiring them to engage on these issues and treat them as being part and parcel of investment management practice would be a step too far compared to the UK approach. Further, the UK is still struggling with inhibitions in common law interpretations of the fiduciary duty for investment fund trustees[62] in terms of being able to take on board non-financial considerations in investment performance.[63] UK company law also treats share ownership as giving rise to quasi-property rights whose exercise should not be arbitrarily curtailed,[64] and hence the prescription of having to cooperate with stakeholders in engagement is likely to be regarded as contrary to shareholder rights and freedoms well-accepted in UK company law.[65] It is arguable that the UK Stewardship Code, being based on the company law framework in the UK, is premised on such a private proprietary conception of share ownership, and there is thus no conception of having to engage or negotiate with stakeholders in the freedom of use of property.

Public disclosure of the exercise of voting rights as required under Article 3f of the proposed Directive also seems to indicate the imposition of accountability on institutions

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[58] See … above.

[59] The previous version of Article 3f can be found

[60] Section 414A, UK Companies Act 2006.

[61] DTI, *Company Law Reform; White Paper* (March 2005) at http://webarchive.nationalarchives.gov.uk/+/http:/www.dti.gov.uk/cld/WhitePaper.pdf; Andrew Keay, 'Enlightened Shareholder Value, The Reform of the Duties of Corporation Directors and the Corporate Objective' [2006] Lloyds Maritime and Commercial Law Quarterly 335.

[62] *Cowan v Scargill* [1985] 1 Ch 270; *Harries and Others V. The Church Commissioners for England and Another* [1992] WLR 1241; Rosy Thornton, 'Ethical Investments: A Case of Disjointed Thinking' (2008) 67 Cambridge Law Journal 396.

[63] Paul Q Watchman, Jane Anstee-Wedderburn and Lucas Shipway, 'Fiduciary Duties in the 21st Century: A UK Perspective' (2005) 19 Trust Law International 127.

[64] *Northern Counties Securities Ltd v Jackson & Steeple Ltd* [1974] 1 WLR 1133.

[65] Above.

beyond their investment management relationship with their beneficiaries. Further, Article 3g specifies further public disclosure obligations on the part of institutions, in relation to their investment strategies, profile and duration of their liabilities and how such contributes to long-term corporate performance. Key elements of institutions' arrangements with their asset managers need to be disclosed. Article 3h also deals with disclosure by asset managers to their institutional clients, in order to account for how asset managers meet their clients' needs in terms of investment horizon and maturity of liabilities. The European Parliament has suggested amendments to require that a part of asset managers' disclosures be made public, with reference to:

(a) how investment decisions are made, in terms of considerations of long term corporate performance and non-financial performance;

(b) explaining the level of portfolio turnover;

(c) the management of actual or potential conflicts of interest in connection with engagement activities;

(d) the use or otherwise of proxy advisors for the purpose of engagement activities; and

(e) how their investment strategy and implementation contributes to the medium to long-term performance of the assets of the institutional investor.

One would have thought that the accountability parameters in investment management would revolve around institutions, their asset managers and other delegates, and their beneficiaries. However, the key tenets of investment management and how they relate to institutions' long term liabilities and the impact on long term corporate performance are now regarded to be of interest for public disclosure under the proposed Directive. The possible public interest in these issues lies in the fact that the private wealth managed by institutions and asset managers are actually the long-term social wealth of the working citizenry, and the financialisation of household and pension savings cannot completely remove the public interest in these issues into the private contractual sphere. Further, as the performance of household and pension savings depends very much on the health of the corporate sector, the sustainability of the financial health of corporate sector also becomes an issue of public interest and not just of investment performance and numbers.

In terms of the public interests underlying the shareholder engagement provisions, the Commission explains[66] that improving shareholder engagement is likely to address the issue of excessive short termism on the part of the asset management industry in managing institutional funds. In the Commission's view, short termism is not conducive for meaningful monitoring of corporate behaviour. Shareholders' short-term demand for financial performance puts pressure on companies, compromising their long-term wealth creation potential. Further, short termism on the part of asset managers adversely affects ultimate returns for institutional beneficiaries. The Commission's concerns are rooted in public interest disquiet regarding the viability of pension savings through investment. Hence, subjecting institutional investment management to standards and scrutiny is arguably a form

[66] Proposed Shareholder Rights Directive, at pp 4, 5, 7 and 8.

of re-regulation, in order to ensure that the privatised and financialised form of social welfare provision may deliver public interest objectives in due course.[67] In this regard, the gradual hardening of shareholder engagement norms serves public interests, and is a form of financial regulation, although such norms are expressed in the corporate governance standards supporting securities regulation.[68]

It may be counter-argued that, as the proposed Shareholder Rights Directive is currently drafted, the Commission stays away from imposing an obligation on institutions to engage, and, hence, institutions remain free to determine the nature of engagement that works best for them. If this is the case, engagement as such, remains in the realm of soft law and the proposed duty to develop an engagement policy may be regarded as a meta-regulatory measure,[69] where regulation sets out broad principles, the detailed implementation of which is left very much to the firm's discretion.

However, as discussed above, there are assumed benchmarks of optimal behaviour i.e. to engage, and much prescription that surrounds the nature of engagement and public disclosure. The provisions of the proposed Directive do not seem to be merely enabling or facilitative for institutional shareholders to enhance their corporate governance positions. Rather, they seem to be more prescriptive as to how institutional shareholders' corporate governance positions should be framed in order to meet public interest objectives. The reference to engagement policies including stakeholder concerns, the reduction of social and environmental risks and cooperation with stakeholders reflect such position. This is a different approach from the UK Stewardship Code which sees its engagement template as one that enhances shareholders' corporate governance positions in the agency-based paradigm of corporate law, if institutions choose to adopt it.

B. Blurring lines: Re-regulation of soft corporate governance standards

In the proposed Shareholders' Rights Directive, the originally soft law of shareholder stewardship appears to be coalescing into hard law. Soft law could indeed be a settled and permanent state for certain norms, as efficiency and contextual reasons may exist for certain norms to be most appropriately structured as soft rather than hard law.[70] Calleiss and

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[67] John Broadbent, Michael Palumbo and Elizabeth Woodman, 'The Shift from Defined Benefit to Defined Contribution Pension Plans - Implications for Asset Allocation and Risk Management' (BIS Working Paper 2006) at http://www.bis.org/publ/wgpapers/cgfs27broadbent3.pdf; Simone Polillo, 'Wildcats in Banking Fields: The Politics of Financial Inclusion' (2011) 40 Theor Soc 347; Ismail Erturk, Julie Froud, Sukhdev Johal, Adam Leaver and Karel Williams, 'The Democratization of Finance? Promises, Outcomes and Conditions' (2007) 14 Review of International Political Economy 553.

[68] Policy underlying the Financial Services Action Plan 1999, Financial Services: Implementing the Framework for Financial Markets- Action Plan (1998) COM (1999)232.

[69] Cary Coglianese and Evan Mendelson, 'Meta-Regulation and Self-Regulation' in R Baldwin, M Cave, and M Lodge (eds), *The Oxford Handbook of Regulation* (Oxford University Press, Oxford), pp. 146–168; Christine Parker, *The Open Corporation* (Cambridge: CUP 2002); 'Meta-Regulation: Legal Accountability for Corporate Social Responsibility' (2006) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=942157; Colin Scott, 'Regulating Everything: From Mega- To Meta-Regulation' (2012) 60 Administration 61.

[70] Ruth V Aguilera, Michael Goyer and Luiz Ricardo Kabbach de Castro, 'Regulation and Comparative Corporate Governance' in M. Wright, D. S. Siegel, K. Keasey, and I. Filatotchev (eds.), *Handbook of Corporate Governance* (Oxford: OUP 2012).

Renner[71] are of the view that soft law may harden when its function arrives at a state of 'stabilisation of normative expectations'. Such is where norms that have been developed to functionally address collective action problems become formalised. They are then applied to resolve disputes in a formal manner.[72] Such outcomes of dispute resolution are, therefore, achieved in a predictable way within an autopoeitic system of norm interpretation. A natural point for soft shareholder stewardship norms to culminate into hard law, such as institutional shareholders' hard law duties, would be where shareholder behaviour is normatively expected to fall within certain frameworks, so that such behaviour, if disputed and adjudicated upon, can be judged within the predictability of those frameworks.

We argue that adjudication of the normative expectations of shareholder conduct is not an immediate development. However, public interest premises on the management of savings in Europe by institutions is the key driver for normative expectations in investment management to be formed, and one aspect of such expectations lies in the normative expectations of shareholder behaviour. We are of the view that the increasing prominence of Anglo-American collective investment funds, even in traditionally blockholder European countries,[73] will entail more scrutiny into their behaviour, The hardening of the soft law of stewardship is unlikely to emanate from the private, agency-based corporate governance premises underlying the UK Stewardship Code, although Stout and Anabtawi caution that minority activist shareholders that are in a position of wielding significant influence may start to give rise to questions as to how they exercise their power, and, consequently, issues of legitimacy and fairness can arise.[74]

The public interest in calling private investment management of financialised social wealth to account will likely re-characterise any legalisation of the norm of stewardship into a form of regulatory accountability beyond the traditional role of shareholders in corporate governance. Hence, we are of the view that the semi-hardening of institutions' duties towards stewardship practices in investment management under the proposed Directive is a temporary position. Unlike the UK's soft law approach which is based very much on accepting that the area of governing the corporation's equity financiers is mainly a non-governmental area, and much of the dynamics in shareholder engagement is a private matter of corporate governance, the Commission's proposal is based on more paternalistic objectives of aligning institutions' role with long-term corporate wealth creation as a social good. Hence, the Commission's adoption of the 'comply or explain' approach[75] seems out of step with the stated regulatory objectives.

Further, corporate governance standards are increasingly being placed at the ambiguous interface between private and public law. Corporate governance aspects may be governed by a mixture of enabling law[76] that gives effect to the 'private bargains' between the various

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[71] Gralf-Peter Calliess & Moritz Renner, 'From Soft Law to Hard Code: The Juridification of Global Governance' (2007) at http://ssrn.com/abstract=1030526 and (2009) 22 Ratio Juris 260.

[72] Ibid.

[73] Ringe, above note 3.

[74] Iman Anabtawi and Lynn Stout, 'Fiduciary Duties for Activist Shareholders' (2008) 60 Stanford Law Rev 1255.

[75] This approach is based on ultimate accountability to shareholders, therefore endorsing the primacy of market discipline. See, further, Parkinson and Kelly, above note 24.

[76] In the form of company law supporting private proprietary and contractual notions, such as in relation to the company's constitution, the conduct of general meetings, the general meeting's power to ratify internal irregularities etc.

stakeholders that make up the corporation ('the nexus of contracts'),[77] and mandatory law that reflects optimal hypothetical bargains between such stakeholders.[78] Enforcement in these matters is often a matter for shareholders or to a limited extent, stakeholders and liquidators. However, securities regulation with its more top-down and protective character has become increasingly infused with corporate governance standards where such standards are important for investor protection.[79] We are of the view that the Commission's proposal will lead the way for the gradual development of securities regulation in respect of precise investment management duties, and a key aspect of that is the publicisation of the relationship between companies and their equity financiers. We believe that such publicisation is a likely trajectory of corporate governance regulation in the future.

This trajectory is part of a wider move to re-bundle corporate governance rules from soft law into securities and financial regulation in recent years. In the EU, the interests of legal integration and harmonisation have resulted in initiatives that harden aspects of corporate governance codes into hard law. The legal harmonisation of shareholder rights is seen as a key measure for promoting capital markets integration as investors have greater confidence in one set of high standards for minority protection. In this respect, policy-makers seemed to have chimed with the early law and finance scholarship[80] that discussed the importance of minority shareholder protection for the attractiveness of securities markets. In EU financial regulation, there is considerable hardening of corporate governance norms for slightly different reasons, as these are seen as related to the proper risk management of financial institutions in order to achieve prudential stability. However, the hardening of corporate governance norms, including the responsibilities and composition of the board of directors, non-executive directors' time commitment to their role, the role of committees of the board of directors, and remuneration regulation,[81] provide seeds for more legal harmonisation to be considered in a broader context. It may be argued that financial sector regulation is unique as prudential concerns loom large and are less applicable to the rest of the corporate sector.[82] However, corporate governance harmonisation in the EU has been progressing stealthily, from the liberalisation of proxy voting in the Shareholders Directive 2007[83] to reforms in annual corporate reporting in 2014,[84] and to introducing a binding shareholder vote on

[77] For example see William A Klein, 'The Modern Business Organization: Bargaining Under Constraints' (1982) 91 Yale Law Journal 1521; Fred McChesney, 'Contractarianism Without Contracts? Yet Another Critique Of Eisenberg' (1990) 90 Columbia Law Rev 1332; Manuel A Utset, 'Towards a Bargaining Theory of the Firm' (1995) 80 Cornell Law Review 540; Stephen Bainbridge, 'Community And Statism: A Conservative Contractarian Critique Of Progressive Corporate Law Scholarship' (1997) 82 Cornell Law Review 856.

[78] Lucian Ayre Bebchuk, 'The Debate On Contractual Freedom In Corporate Law' (1989) 89 Columbia Law Rev 1395; David Charny, 'Hypothetical Bargains: The Normative Structure Of Contract Interpretation' (1991) 89 Michigan Law Review 1815; Marc Moore, above note **Error! Bookmark not defined.**, arguing that mandatory law reflects efficiency bargains in the view of the state and goes beyond 'hypothetical bargains'.

[79] See section 89O, Financial Services and Markets Act 2000.

[80] R La Porta,.F Lopez-De-Silanes and A Shleifer, 'What Works in Securities Laws' (2006) 71 Journal of Finance 1; 'Legal Determinants of External Finance' (1997) 52 Journal of Finance 1131.

[81] See Arts 88ff, Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV Directive 2013).

[82] Massimo Belcredi and Guido Ferranini, 'The European Corporate Governance Framework: Issues and Perspectives' (2013) at http://ssrn.com/abstract_id=2264990.

[83] Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies.

[84] Directive 2014/95/EU on disclosure of non-financial and diversity information by certain large undertakings and groups.

executive remuneration, and galvanising shareholder engagement generally in the proposed Shareholder Rights Directive.

It is within this context that the proposed Shareholders' Rights Directive rightly deals with the 'publicisation' of stewardship norms as the European perspective of corporate governance should not be confined to an Anglo-American one that emphasises the private and closed nature of corporate governance and intra-accountability.[85] Such a perspective has arguably, artificially and unfairly shut stakeholders[86] and the wider community out of discourse as to the normative objectives and accountability of the modern corporation.[87] Hence, the proposed Directive's approach to frame clearly the institutional shareholders' obligations and to introduce avenues of public accountability for them serves as an articulation of social expectations of institutional shareholders. However, this view of the corporation may not be universally shared in Europe.[88] We argue that any harmonisation of prescriptions for institutional shareholder conduct should be better carried out under the premises of securities or financial regulation, which will then open the way for debating more honestly and openly the role of securities regulators in scrutinising investment management practices in relation to the wider public interest in long term pension savings and the financial health of the corporate sector sustaining the viability of such savings. The hardening of the soft law of shareholder stewardship seems to be on the cards, but only an examination of the apparently contradictory character of Articles 3f to 3h in the Directive and its underlying premises may explain the fundamentally different character of such potential legalisation.

In sum, the position adopted by the Commission's proposed Directive contains many regulative and prescriptive elements within a wrapper of a comply-or-explain approach for institutions as regards shareholder engagement. This approach is inherently contradictory, especially given the expansion of the regulative aspects that the European Parliament has now introduced in the amended text. We argue that Articles 3f to 3h are a step towards the regulation of investment management practice. These Articles do not merely embody articulations of shareholder conduct for the purposes of a firms' corporate governance frameworks. Perhaps the tentative approach to regulating investment management practices is due to the hitherto lack of international consensus in regulating the buy-side in finance, which is disproportionately less regulated than the sell-side, although both sides give rise to issues

[85] Frank H Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law* (Mass: Harvard University Press 1996); Brian R Cheffins, *Company Law: Theory, Structure and Operation* (Oxford: OUP 1997).

[86] Margaret Blair, *Ownership and Control : Rethinking Corporate Governance in the Twenty-First Century* (1995); Margaret M Blair & Lynn A Stout, 'A Team Production Theory of Corporate Law' (1999) 85 Virginia. L. Rev. 247; Colin Mayer, *Firm Commitment* (Oxford: OUP 2013); R Edward Freeman, 'A Stakeholder Theory of the Modern Corporation' reproduced in Max BE Clarkson ed, *The Corporation and Its Stakeholders* (Univ of Toronto Press 1998) at 125.

[87] Colin Mayer, *Firm Commitment* (Oxford: OUP 2013); Andrew Keay, *The Corporate Objective* (Cheltenham: Edward Elgar 2011); JE Parkinson, *Corporate Power and Responsibility* (Oxford: Clarendon Press 1993).

[88] For example, see Eddy Wymmersch, 'Convergence or Divergence in Corporate Governance Patterns in Western Europe' in Joseph McCahery (ed), *Corporate Governance Regimes: Convergence and Diversity* (Oxford: OUP 2002); Paul Davies and Klaus J Hopt, 'Boards in Europe: Accountability and Convergence' (2013) 61 American Journal of Comparative Law 301.

of public concern such as financial stability and sustainability.[89] However, as regulatory scrutiny over the buy-side is only emerging at the international level,[90] perhaps the Commission does not wish to engage in such regulatory initiatives until international wisdom has matured in this area.

V. Conclusion

This Chapter has discussed how the soft law of shareholder stewardship originating in the UK Stewardship Code can develop into hard law forms and why this is becoming increasingly important to global capital markets. The growing institutionalisation of national, European and global markets for shares, even in markets which were traditionally dominated by blockholders, was among the triggers for the global diffusion of soft law stewardship norms on the part of institutional investors and asset managers. Spurred on by the public interest in ensuring that private investment management delivers certain public interest objectives such as pension savings for the retired population, the further formalisation of shareholder duties on the part of institutional investors into hard law, as developed from shareholder stewardship, could be regarded as part of a strategy towards making investment management long-termist and accountable.

At the EU level, the proposed Shareholder Rights Directive 2014 is arguably a step in that direction. The proposed Directive requires that shareholder engagement be considered as an integral practice in investment management and can be seen as part of the supply side design for market integration through securities regulation. We argue that the proposed Directive is not far short of imposing a *duty to demonstrate engagement* on the basis of public policy concerns and such a duty is not incongruent with the diverse ownership structures in different jurisdictions, whether featuring dispersed or concentrated ownership. This somewhat 'hardening' of shareholder behaviour norms is not as a result of catering to bottom-up forces and market demand for corporate governance norms. Rather, it appears to be a re-regulatory measure rooted in public interest concern. This suggests that the increasing prescription towards shareholder behaviour addresses other public interest concerns beyond the private law dynamics of dispute resolution with respect to shareholder behaviour.

Although the Commission's proposal is tentative on completely hardening the soft law of shareholder stewardship, we are of the view that the time is ripe and such normative transformation of the emerging law of shareholder stewardship may be on the horizon. However, policy-makers need to be more honest and open about the regulatory objectives and premises underlying such legalisation of institutional shareholder duties.

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[89] The buy-side in finance has consistently resisted regulation, for example, see the debates surrounding whether large asset managers should be subject to increased regulation in light of prudential concerns, FSB, *FSB and IOSCO propose Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions* (4 March 2015), and the recent retreat of regulatory fervour in the wake of lobbying by asset managers, see 'Plans to label big fund managers 'systemic' in jeopardy', *Financial Times* (17 June 2015); 'Fund Managers to escape systemic label', *Financial Times* (14 July 2015).

[90] For example, FSB and Iosco, *FSB and IOSCO publish Public Responses to the Second Consultative Document on NBNI G-SIFI Assessment Methodologies* (12 June 2015) at http://www.financialstabilityboard.org/2015/06/fsb-and-iosco-publish-public-responses-to-the-second-consultative-document-on-nbni-g-sifi-assessment-methodologies/.