

Asset Managers as Stewards of Sustainable Business

Implications of the Rise in Passive Investing

Morningstar Manager Research

9 October 2019

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Key Takeaways

- ▶ The rise of passive investing and growing awareness of the financial materiality of environmental, social, and governance considerations make the role of asset managers in corporate governance more important than ever before.
- ▶ While asset managers have incentives to engage with portfolio companies, countervailing incentives—such as cost, regulatory concerns, and risk of backlash—make their level of opposition to management in proxy voting suboptimal in addressing systemic financial risks like climate change.
- ▶ An evolving and converging stewardship practice can be traced through sign-on stewardship codes and growing collaboration amongst investors. These require investment fiduciaries to use their influence over corporate governance arrangements at investee companies to promote sustainable business practices.
- ▶ Given the apparent advantages to all investors of mobilizing passive investor stewardship muscle, this paper views stronger disclosure standards around engagements and supportive frameworks for investor collaboration as policy approaches that would encourage active stewardship by passive asset managers.

Introduction

The rapid rise of passive investing has been a defining trend of global financial markets over the past 10 years. The shift from active to passive investing strategies has resulted in passive funds reaching almost 50% of U.S. equity fund market share this year¹ and likely to reach 25% share of the European fund market by 2025.²

At the same time, the asset-management industry is becoming more concentrated. The combined share of U.S. fund assets managed by the five largest firms rose from 35% in 2005 to 51% in 2018.³ Since the global financial crisis, changing patterns of investing have given rise to a new category of asset manager—the early providers of low-cost, index-tracking investing strategies who benefited from a first-mover advantage in a business that affords huge returns on scale. The economics of doing business in

1 Lauricella, T., and DiBenedetto, G. 2019. "A Look at the Road to Asset Parity Between Passive and Active U.S. Funds." June 12, 2019. *Morningstar Blog*. <https://www.morningstar.com/blog/2019/06/12/asset-parity.html>.

2 Bioy, H.; Garcia-Zarate, J.; Lamont, K.; Boyadzhiev, D.; and Kang, H. 2019. "A Guided Tour of the European ETF Marketplace." Morningstar Manager Research EMEA. April 24, 2019. http://images.mscomm.morningstar.com/Web/MorningstarInc/%7bd4288644-b38b-47c0-b4fb-a4b9b87192f8%7d_A_Guided_Tour_of_the_European ETF_Marketplace.pdf.

3 Investment Company Institute. 2019. Investment Company Institute Fact Book, Share of Mutual Fund and ETF Assets at the Largest Fund Complexes. Figure 2.12, page 45. https://www.ici.org/pdf/2019_factbook.pdf.

the asset-management industry have been changing dramatically, and predictions are that investor price-sensitivity and growing competition for assets will drive further consolidation.⁴

A recent National Bureau of Economic Research working paper by academics Lucian Bebchuk and Scott Hirst⁵ calculates that the percentage of S&P 500 corporate equity controlled by the three largest index fund providers—BlackRock, Vanguard, and State Street—rose to 20.5% in 2017 from 13.5% in 2008, and that Vanguard and BlackRock each held 5% positions in almost all S&P 500 companies. On this trajectory, the authors predict that their combined stake could rise above 27% of S&P 500 equity holdings in 10 years, and up to 33% in 20 years.

The growing portion of equity shares controlled under passive investing strategies and rising concentration in the asset-management industry have important implications for investment stewardship. In particular, long-term corporate decisions relating to ESG risks are and will continue to be deeply affected by the stewardship approach of large asset managers who take a primarily passive approach to investing.

In this paper we address the following broad questions: How do passive asset managers, particularly the large ones, exercise their stewardship responsibilities? Are asset managers that offer index-tracking and exchange-traded funds sufficiently incentivized to use their control rights to address urgent ESG risks, such as climate change? What policy strategies would encourage passive investors to play a more active role as stewards of capital markets?

We draw on an emerging body of academic research that explores the stewardship implications of the shift to passive funds. This literature focuses almost exclusively on the emergence of the Big Three players: BlackRock, Vanguard, and State Street. It grows out of a longer line of research that explores reasons for the historically low levels of opposition to management in asset manager proxy voting, particularly with respect to shareholder-sponsored ballot initiatives. The general theme that the Big Three literature addresses is whether passive investing will lead to stronger or weaker investor oversight of corporate governance.⁶

Stewardship codes and global investor collaboration are shaping a new stewardship practice that emphasizes the fiduciary responsibility of asset managers to be stewards of capital markets. They emphasize greater stewardship transparency, particularly around engagement, and promote stronger coordination among investors in addressing systemic ESG risks. Specific developments—code revisions

4 Waite, S.; Massa, A.; and Cannon, C. 2019. "Asset Managers with \$74 Trillion on Brink of Historic Shakeout." *Bloomberg*. Aug. 8, 2019. <https://www.bloomberg.com/graphics/2019-asset-management-in-decline/>.

5 Bebchuk, L., and Hirst, S. 2019. National Bureau of Economic Research Working Paper 25914. "The Specter of the Giant Three." June 2019. <https://ssrn.com/abstract=3401620>.

6 In this paper we focus only on the stewardship implications of passive investing. Related literature considers the impacts of passive, or index-tracking, investment strategies on financial stability via marketplace impacts like trading patterns and price discovery. See: Anadu, K.; Kruttli, M.; McCabe, P.; Osambela, E.; and Hee Shin, C., 2018, Finance and Economics Discussion Series, "The Shift from Active to Passive Investing: Potential Risks to Financial Stability?," Aug. 27, 2018, <https://doi.org/10.17016/FEDS.2018.060>. See also, regarding the competitive impacts of common ownership: Azar, J.; Schmalz, M.; and Tecu, I.; 2017, *Journal of Finance*, "Anti-Competitive Effects of Common Ownership," Vol 73, Issue 4; <https://onlinelibrary.wiley.com/doi/10.1111/jofi.12698>.

and models for collaborative engagement—have an important bearing on whether increased passive investing could be accompanied by more-active stewardship towards sustainable business practices.

Two important policy strategies for encouraging more active stewardship by the providers of passive investments are better engagement disclosure with more standardized metrics, and encouraging collaborative engagement on shared ESG concerns.

This paper consists of the following seven sections. In Section II, we provide an overview of how the proxy process supports investment stewardship and the emerging global institutional framework shaping asset-manager stewardship practices. Section III provides an overview of regulatory guidelines around the world that manifest an increased focus on stewardship. Section IV describes the incentives of the largest providers of indexed funds to become more forceful advocates for sustainability through engagement and proxy voting. In contrast, Section V reviews explanations for asset managers' relative voting passivity. Section VI explains how global investor coalitions are driving consensus among investors about the governance strategies required for addressing financially material ESG risks. Section VII describes policy initiatives that promote transparency around engagements and enable investor collaboration, thereby strengthening the role of passive asset managers as stewards of capital markets. Section VIII concludes the report.

Asset Managers are Stewards of Investment Capital

Asset managers occupy an important role in the “stewardship ecosystem.”⁷ They collectively represent a large pool of capital which affords them a powerful role as financial stakeholders, including as shareholders in public companies. As shareholders, they have the right to cast votes on directors, on pay practices, and on other issues that bear directly on the corporate-governance practices of portfolio companies. Governance practices have a strong bearing on risk management and strategic leadership, and aid investee companies, thereby driving value at both the company and portfolio levels.

This means that an asset manager has a responsibility to exercise the control rights attached to the assets in their portfolios when doing so is in the best interests of fund beneficiaries—the pension funds, insurance companies, foundations, endowments, and individuals whose investments they manage. Fundamental to these control rights is the right to vote shares. Asset managers are therefore subject to rules, including disclosure rules, intended to define and strengthen this agency relationship.⁸

Historically, large asset managers have been less likely than other types of investors to vote against management and to initiate shareholder resolutions. Explanations offered in the academic literature

⁷ We borrow this term from Novick, B.; Edkins, M.; and Clark, T., 2018, Harvard Law School Forum on Corporate Governance and Financial Regulation, “The Investment Stewardship Ecosystem,” July 24, 2018; <https://corpgov.law.harvard.edu/2018/07/24/the-investment-stewardship-ecosystem/>.

⁸ For instance, the SEC confirmed, “As a fiduciary, an investment adviser owes each of its clients a duty of care and loyalty with respect to services undertaken on the client’s behalf, including proxy voting.” United States Securities and Exchange Commission. 2014. Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms, Staff Legal Bulletin No. 20 (IM/CF). June 30, 2014. <https://www.sec.gov/interps/legal/cfslb20.htm>.

include potential conflicts of interest in opposing management, cost of active ownership, and regulatory and political forces incentivizing deference to corporate management.

Up to the end of the 1990s, the dispersed ownership structure of public corporations was seen as the main cause of weak investor oversight. Investors could apply the “Wall Street Rule” and sell shares when they had lost confidence in management. Even though mutual funds collectively controlled 21% of the U.S. equities market in 2001,⁹ no fund company was dominant enough to capture the benefits of active ownership.

Their failure to take a more active role in corporate governance was viewed as one of the enabling factors in the accounting scandals that rocked financial markets in 2001 and 2002 (the highest-profile cases included Enron, Global Crossing, Tyco, and WorldCom). The SEC’s 2002 proxy voting disclosure rule was positioned as a way of addressing this passivity. The introduction to the rule notes that “[T]he increased equity holdings and accompanying voting power of mutual funds place them in a position to have enormous influence on corporate accountability.”¹⁰

The Proxy Gives Shareholders a Voice in Corporate Governance

When investors own shares in companies, they also own the right to vote those shares at annual shareholder meetings. By voting on items that appear on corporate proxy ballots, shareholders can shape corporate governance practices.¹¹

Through the proxy process, shareholders may be entitled to propose issues to be voted on in shareholder meetings. Shareholder resolution filing is a prominent feature of the U.S. proxy process. Environmental, social, and governance issues surface on the proxy ballot and are debated both in the text of proxy materials and on the floor of the shareholders’ meeting. The process draws attention to risks and potential weaknesses in corporate-governance practices and is a valuable feature of the U.S. securities market.

In other jurisdictions, shareholders propose far fewer resolutions, although shareholders may have a wider range of standard ballot items on which to vote—such as auditor remuneration, approving the audited financial statements, and an advisory vote on payments to directors. Under European Union member states’ corporate law, shareholding requirements for filing resolutions are higher than under SEC regulations, where shareholders are only required to hold \$2,000 for at least one year prior to filing a resolution, and therefore fewer shareholder resolutions come to vote each year. However, under EU member states’ corporate law, the vote outcome is generally binding if supported by a majority of

9 Investment Company Institute. 2002. “Mutual Fund Fact Book,” page 26. https://www.ici.org/pdf/2002_factbook.pdf.

10 United States Securities and Exchange Commission. 2003. Final Rule: Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies. April 14, 2003. <https://www.sec.gov/rules/final/33-8188.htm>.

11 For a review of the U.S. proxy process, see Cook, J., 2019, “A Closer Look at Shareholder Democracy and the Proxy Process.” Morningstar. March 6, 2019. <https://www.morningstar.com/blog/2019/03/06/proxy-process.html>.

shareholders, unless company articles specifically require a supermajority level of support.¹² In the U.S., almost all shareholder resolutions are merely advisory, regardless of the vote's outcome.

¹² O'Sullivan, D. 2017. ShareAction. "A Guide to Shareholder Rights Across Six European Countries." March 2017. <https://shareaction.org/wp-content/uploads/2017/03/ShareholderRightsEurope.pdf>.

The Proxy Gives Shareholders the Power to Engage

The power to vote on proxies and to propose ballot items for vote gives shareholders a degree of access to corporate management. Shareholders can use this access to engage in a dialogue with corporate management and board members over corporate governance and other concerns. The filing of a resolution can often function as the opening to this dialogue, with a successful outcome leading to the withdrawal of the resolution. The most recent proxy season saw high-profile withdrawals of shareholder resolutions requesting companies to set greenhouse gas emission reduction targets, such as at Emerson Electric EMR, filed by Boston Trust Walden, and EOG Resources EOG, filed by Trillium Asset Management. BP BP recommended that shareholders vote for a shareholder resolution requesting disclosure of how BP's business strategy aligns with the goals of the Paris Climate Agreement.¹³ These outcomes were the result of engagement following resolution filing.

Engagement can also take place without shareholders filing a resolution, often initiated by larger shareholders or via coalitions of shareholders collectively holding a sizable stake in a company. It can take the form of anything from a letter to an extended in-person dialogue, and large asset managers typically use a combination of strategies to escalate an issue with corporate management and board members.¹⁴

Proxy voting and engagement are complementary strategies in the stewardship toolbox of shareholders. Engagement offers management the opportunity to hear from investors who provide valuable perspectives on risks and solutions. Proxy voting gives effect to the engagement process by offering shareholders a strategy for raising issues to be addressed, and a way for markets to signal a degree of concern where governance practices are inadequate. Engagement is underwritten by an investor's willingness to vote against proposed compensation arrangements and board nominees, or by supporting shareholder resolutions proposing governance arrangements and disclosures that address ESG risks.

The Process of Engagement Varies Across Managers

While mutual fund and ETF investors hold economic entitlements to the assets held collectively by funds in which they invest, the fund itself holds the voting rights, or control rights, attached to the assets. Proxy voting guidelines issued by fund sponsors provide a framework within which individual votes are decided. However, within a fund group, the vote may be administered in a variety of ways, representing varying degrees of centralization. For instance, State Street's votes are centrally administered across all funds. While all votes cast across Vanguard Group's suite of funds used to be centralized, the asset manager recently relinquished the voting rights over actively managed funds to the managers of those funds, including Wellington Asset Management, Primecap, and others.¹⁵ Invesco's fund managers cast their votes via a central, proprietary proxy voting platform on which insights can be shared and

¹³ United Nations. 2016. United Nations Framework Convention on Climate Change, Paris Agreement. Nov. 4, 2016. <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>.

¹⁴ Engagement by asset managers has been described in greater detail. See Mallow, J., and Sethi, J.; 2016; "Engagement: The Missing Middle Approach In The Bebchuk-Strine Debate." *New York University Journal of Law & Business*. May 2016. <https://www.blackrock.com/corporate/literature/publication/mallow-sethi-engagement-missing-middle-approach-may-2016.pdf>.

¹⁵ Franck, T. 2019. "Vanguard to Surrender Some of its Corporate Voting Power to External Fund Managers." CNBC. April 25, 2019. <https://www.cnbc.com/2019/04/25/vanguard-to-give-up-some-of-its-voting-power-to-external-fund-managers.html>.

differences debated.¹⁶ Fidelity's actively managed funds are voted independently by the managers of the individual funds, while Fidelity's index funds are voted uniformly by the subadvisor, Geode Capital Management.¹⁷ Anecdotally, it appears that providers of passive funds tend to centralize proxy voting, whereas portfolio managers of active funds tend to have greater proxy voting independence.

Passive management is a scale business, and this goes for the stewardship function as well: Engagement coverage and voting research can be leveraged across a suite of funds offered by a single asset manager to scale the impact of a fund sponsor's stewardship efforts.

Focus on Stewardship has Increased Globally

The launch of the United Nations Principles for Responsible Investment in 2006 (now called the "PRI") drew global attention to the role of shareholders in advancing sustainable business through investment practices. It followed the groundbreaking Freshfields Report,¹⁸ commissioned by the United Nations Environment Programme Finance Initiative's Asset Manager Working Group, which addressed the question:

"Is the integration of environmental, social and governance issues into investment policy (including asset allocation, portfolio construction and stock-picking or bond-picking) voluntarily permitted, legally required or hampered by law and regulation; primarily as regards public and private pension funds, secondarily as regards insurance company reserves and mutual funds?"¹⁹

This report concluded that part of a fiduciary's duty is to consider ESG factors in investing, paving the way for the mainstreaming of responsible investment, now known as "ESG investing." It was followed up in 2015 with another influential opinion on the role of ESG in investing, called "Fiduciary Duty in the 21st Century."²⁰

This report went further, concluding that:

"Failing to consider long-term investment value drivers, which include environmental, social and governance issues, in investment practice is a failure of fiduciary duty."²¹

The PRI's founding partners were the UN Global Compact and UNEP-FI, and it operates as an independent, industry-led membership network of asset managers, asset owners, and service providers. Early signatories were social investment asset managers and public pension funds. However, the

16 Invesco. 2019. Proxy Voting. <https://www.invesco.com/corporate/about-us/proxy-voting>.

17 Fidelity. 2019. Proxy Voting. <https://www.fidelity.ca/fidca/en/proxy>.

18 UNEP Finance Initiative. 2005. A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment. October 2005. https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf.

19 A Legal Framework, page 6.

20 Sullivan, R.; Martindale, W.; Feller, E.; and Bordon, A. 2015. UNEP Finance Initiative. Fiduciary Duty in the 21st Century. https://www.unepfi.org/fileadmin/documents/fiduciary_duty_21st_century.pdf.

21 Fiduciary Duty in the 21st Century, page 9.

exponential growth in the volume of assets under management accounted for by the PRI's membership base is mainly due to asset-manager membership growth, especially since 2014. These principles provide members with a framework within which to develop a sustainable investing approach and a stewardship strategy.

Around the world, securities regulation and industry-derived codes of best practice recognize stewardship as a responsibility of investment fiduciaries. Important regulatory developments and self-regulatory initiatives are shaping and extending the stewardship responsibilities of investment fiduciaries, particularly asset managers, and driving a global convergence of stewardship practices. Stewardship codes articulate the responsibilities and acceptable strategies of investment fiduciaries to shape the governance practices of investee companies. As shown in the Appendix, most stewardship codes are not binding. In some cases, disclosure expectations around stewardship are mandated by regulation. In general, asset managers either choose to comply or are required to disclose reasons for noncompliance on a "comply or explain" basis, meaning that they must explain deviations from the guidelines to which they are subject or have voluntarily signed on to. Where compliance is voluntary, enforcement is through the market—it is up to clients to ask why an asset manager is not acting in accordance with the principles to which it has agreed.²²

The recently adopted Investor Stewardship Group Framework for U.S. Stewardship and Governance, the first set of stewardship principles applying specifically to U.S. asset managers, is an example of an investor-initiated stewardship code. It consists of six stewardship principles applicable to institutional investors and six governance principles applicable to U.S.-listed companies. Signatories to the ISG framework include the largest U.S. asset managers.²³

The most recent set of amendments to the European Shareholder Rights Directive (also known as SRD II) was adopted by the European Council in 2017,²⁴ replacing the original directive of 2007.²⁵ European Union member states were required to transpose these amendments—which include extending shareholders' voting rights and imposing greater transparency obligations on institutional investors, asset managers, and proxy advisors—into national law by June 10, 2019.

SRD II requires that institutional investors and asset managers, on a "comply or explain" basis, annually disclose their proxy voting and engagement policies and explain how they are implemented:

"[T]he [stewardship] policy shall describe how [asset managers] monitor investee companies on relevant matters, including strategy, financial and non-financial performance and risk,

²² Hill distinguishes codes issued by regulatory bodies on behalf of governments, such as the UK, Denmark, Hong Kong, and a few other jurisdictions, from those issued either by private bodies or by investor-led initiatives. See: Hill, J. 2017. "Good Activist/Bad Activist: The Rise of International Stewardship Codes." *Seattle University Law Review*. Sept. 1, 2017. <https://ssrn.com/abstract=3036357>.

²³ Investor Stewardship Group. 2019. ISG Signatories and Endorsements. <https://isgframework.org/signatories-and-endorsers/>.

²⁴ European Union. 2017. "The Shareholder Rights Directive II." Official Journal of the European Union. May 17, 2017. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017L0828&from=EN>.

²⁵ European Union. 2007. "The Shareholder Rights Directive I." Official Journal of the European Union. July 14, 2007. <https://eur-lex.europa.eu/eli/dir/2007/36/oj?eliuri=eli:dir:2007:36:o>.

capital structure, social and environmental impact and corporate governance, conduct dialogues with investee companies, exercise voting rights and other rights attached to shares, cooperate with other shareholders, communicate with relevant stakeholders of the investee companies and manage actual and potential conflicts of interests in relation to their engagement.”²⁶

These disclosure requirements bring the EU in greater alignment with the U.S., where mutual funds have long had to disclose their proxy votes. They go further than the U.S. in requiring disclosure of monitoring and engagement practices, and in specifically referencing ESG impact as a subject for monitoring and engagement.

Further, SRD II has spurred important stewardship code revisions. In May 2018, the European Fund and Asset Management Association, which represents the European investment management industry, released a revision to its stewardship code, originally adopted in 2011, to integrate the stewardship requirements of SRD II. It requires asset managers to disclose significant votes and indicates that they should be disclosed publicly on their websites. It also urges both active and passive asset managers to engage with companies on a long-term basis, and to address ESG concerns.

A review of the U.K. Stewardship Code was announced in January 2019. Proposed amendments make specific reference to the Paris Climate Agreement,²⁷ the UN 2030 Agenda for Sustainable Development,²⁸ and the Task Force on Climate Related Financial Disclosures (TCFD)²⁹ in providing an international context for the Code revision, noting the increased expectations on investors to consider ESG issues.³⁰ Since the UK has held a leadership role in codifying investor stewardship responsibilities, with emulation by countries such as South Africa, it is likely that other codes will also incorporate these references in their next round of review. These ongoing reforms further institutionalize the responsibility of investors, including asset managers, to be actively engaging corporate management on ESG issues and to be incorporating ESG considerations into proxy voting.

Passive Investment Managers Have Incentives to Be Long-Term Stewards

Regulators have a clear interest in encouraging shareholders to be active owners or vigilant market participants on ESG issues. Below, we review the arguments for, and evidence of whether, the largest asset managers are taking up the role of stewards of capital markets.

²⁶ Shareholder Rights Directive II, Article 3g.

²⁷ United Nations. 2018. United Nations Framework Convention on Climate Change, Paris Agreement. <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>.

²⁸ United Nations. 2019. Sustainable Development Goals. <https://sustainabledevelopment.un.org/?menu=1300>.

²⁹ Task Force on Climate-Related Financial Disclosures. 2019. <https://www.fsb-tcfid.org/>.

³⁰ Financial Reporting Council. 2019. Consulting on a Revised UK Stewardship Code. Jan. 10, 2019. <https://www.frc.org.uk/getattachment/dff25bf9-998e-44f6-a699-a697d932da60/;.aspx>.

Contrary to their investment styles, large asset managers providing passive investment vehicles have direct incentives to be active stewards—in theory. Recent academic research on asset-manager stewardship practices, mostly focusing on the Big Three, discerns three key incentives.

Passive Managers Can Vote but Not Sell

Perhaps the most obvious is that, by tracking indexes, passive investors are exposed to risks that they cannot diversify away from across markets and over time. The Big Three providers of passively managed investment vehicles—BlackRock, Vanguard, and State Street—have been referred to in the academic literature as “New Permanent Universal Owners.”³¹ With no exit option, these asset managers are obliged to use their voice and to advocate for long-termism. Larry Fink’s 2018 letter to CEOs notes that “[I]ndex investors are the ultimate long-term investors—providing patient capital for companies to grow and prosper.”³²

Passive Managers Achieve Scale in Active Ownership

Secondly, with large-enough stakes in portfolio companies, the largest asset managers capture a greater share of value from governance improvements and achieve economies of scale in monitoring, conducting engagements, and actively voting proxies. Given that active ownership is costly and the rewards to, mostly, unobserved stewardship efforts are spread across the entire investor base of targeted companies, investors are rationally deterred from investing in active ownership strategies. The rewards may not justify the effort required for any one investor acting alone. However, where large asset managers centralize their stewardship efforts, they can leverage engagements and proxy research to secure corresponding investment-risk reductions across the portfolios of their entire suite of fund offerings.

Stewardship Is a Service

Third, with almost uniformly low fees and competitors following undifferentiated investment strategies, an asset manager’s stewardship approach is a potentially valuable part of the branding of an index fund family.³³ Competition among fund sponsors creates incentives for large providers of passive funds to invest in stewardship as a brand differentiator. End investors care about fees. However, increasingly, they also care about what their funds are invested in and how their funds are stewarded. A healthy competition between providers of index funds and providers of managed funds in the provision of stewardship services reduces the incentive to economize on stewardship to reduce operational costs.³⁴

31 Academics Jan Fichtner and Eelke Heemskerk coined this term. Fichtner, J., and Heemskerk, E. 2018. “The New Permanent Universal Owners: Index Funds, (Im)patient Capital, and the Claim of Long-termism.” *CorpNet Working Paper*. Nov. 13, 2018.

32 Fink, L., and BlackRock. 2018. Larry Fink’s Annual Letter to CEOs: A Sense of Purpose. <https://www.blackrock.com/hk/en/insights/larry-fink-ceo-letter>.

33 Fisch, J.; Hamdani, A.; and Davidoff Solomon, S. 2018. “The New Titans of Wall Street: A Theoretical Framework for Passive Investors.” *University of Pennsylvania Law Review*. June 6, 2018. <https://ssrn.com/abstract=3192069>.

34 The New Titans of Wall Street.

At the end of 2018, 74 ESG ETFs were available in the U.S., with a number of new launches during the year.³⁵ At the end of 2017, there were nearly 270 sustainable index mutual funds and ETFs worldwide, with Europe accounting for the majority of the \$102 billion in collective AUM.³⁶ Fund investors naturally expect stewardship to align with the ESG purpose of funds. If large passive asset managers make this commitment with respect to newer ESG fund offerings, they reduce the marginal cost of active stewardship across their entire portfolios.

Evidence Suggests That Asset Managers Are Engaging More

Not only do passive investors have stronger incentives to undertake stewardship activities — they also enjoy structural advantages in doing so, wielding an often-pivotal voting power. This voting power opens doors to engagement, which affords them a powerful mode of influence.

Citing specific initiatives undertaken by the Big Three as well as their membership to the Council of Institutional Investors, which advocates for policies that promote corporate governance best practices, Fisch et al. argue that passive investors are assuming a more prominent role in policy advocacy aimed at protecting shareholders' rights to exercise their voice.³⁷ This advocacy extends their influence beyond company-level stewardship and is consistent with their interest in securing stable financial markets. Fisch et al. and Jahnke observe the parallel growth in passive investing and the propensity of large providers of passive investment vehicles to engage corporate management on themes like climate risk and gender diversity.³⁸ Environmental, social, and governance themes are now a prominent part of the engagement reports put out by the Big Three.³⁹

Bioy et al.⁴⁰ surveyed 12 of the largest providers of index funds and ETFs globally, including the Big Three, and found that all except one of the largest passive fund providers were taking an active approach to stewardship in one way or another, or had near-term plans to do so. The study found evidence of increased commitment to stewardship in the expansion of stewardship teams. Furthermore, of the nine managers that engaged directly with investee companies, including the Big Three, there appeared to be a growing emphasis on the use of this strategy. Of the three managers that did not have engagement programs, two reported at the time that they had plans to formalize a stewardship strategy in 2018.

35 Hale, J. 2019. Sustainable Funds U.S. Landscape Report. Morningstar Research. February 2019.

https://www.morningstar.com/content/dam/marketing/shared/pdfs/sustainability/Sustainable_Funds_Landscape_2018.pdf?cid=EMQ_&utm_source=eloqua&utm_medium=email&utm_campaign=&utm_content=15988.

36 Bioy, H. and Lamont, K. 2018. "Passive Sustainable Funds: The Global Landscape." *The Journal of Index Investing*. Winter 2018.

<https://doi.org/10.3905/jii.2018.1.063>.

37 The New Titans of Wall Street.

38 Jahnke, P. 2017. Voice Versus Exit: The Causes and Consequence of Increasing Shareholder Concentration. University of Edinburgh School of Social and Political Science. Sept. 18, 2017. <https://ssrn.com/abstract=3027058>.

39 1. State Street. 2019. Stewardship Activity Report (summarizing types of engagements by region in 2018). <https://www.ssga.com/investment-topics/environmental-social-governance/2019/03/stewardship-activity-report-q4-2018.pdf>. 2. Vanguard Investment Stewardship. 2019. Semiannual Engagement Update. <https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2019-semiannual-engagement-update.pdf>. 3. Fink's Annual Letter to CEOs: "Most recently, we held a strategic engagement with members of [a US energy company's] board and management and had a collaborative discussion about board education and evolution."

40 Passive Sustainable Funds.

Countervailing Incentives Limit Voting

Despite evidence of growing engagement, analyses of proxy voting records following the start of annual disclosures in 2004 continued to note that the largest asset managers generally underutilize their proxy voting power: Their overall level of voting support for shareholder resolutions addressing ESG issues remains far lower than most of their peers.⁴¹ Furthermore, the largest asset managers appear to ratify board nominees and approve executive compensation practices more readily than most of their peers, even where there exists strong evidence of governance problems.⁴²

Earlier academic research explaining asset-manager voting passivity focused on agency problems and collective action costs involved in opposing corporate management, and in investing in monitoring and active ownership, respectively. Some studies found that reliance on the 401(k) plan management business seemed to attenuate asset managers' inclination to vote against management and support shareholder proposals, and assumed the existence of a conflict of interest in cases where corporate management typically had deciding power over 401(k) service provider selection.⁴³ Others found that active voting was a function of an asset manager's exposure to firm performance, lending support to the collective action cost explanation.⁴⁴ Under a dispersed shareholding structure where individual effort is unobservable, individual asset managers are unable to capture enough of the benefits of active ownership and, therefore, collectively, are not incentivized to make optimal investments in the stewardship activities required to secure better corporate governance at investee companies.

The dynamics that support these two explanations for asset-manager voting passivity are changing in at least three important ways:

1. The asset-management industry is becoming more concentrated and managers are therefore better able to capture value from investments in stewardship.
2. Stewardship codes and collaborative engagements reduce the overall cost of active ownership by increasing transparency and accountability, and by achieving scale.
3. Environmental, social, and governance issues are moving center stage as material investment risks, obliging asset managers to take a position in their investment strategies.

While the largest asset managers are becoming incrementally more supportive of social and environmental issues on proxy ballots, the votes of the Big Three fall far short of many of their peers and seem in many cases to run contrary to public statements on ESG risks.

41 For example, see: *Ceres' 2019 survey of asset managers' votes on climate-related shareholder resolutions*. Berridge, R. 2019. "As Climate Change Causes a Maelstrom of Financial Risks and Opportunities, is Your Money Manager Prepared to Weather the Storm?" *Ceres*. March 3, 2019. <https://www.ceres.org/news-center/blog/climate-change-causes-maelstrom-financial-risks-and-opportunities-your-money>. See also: Gladman, K. 2018. *50/50 Climate Project*. Asset Manager Climate Scorecard 2018, Table 1. <https://5050climate.org/wp-content/uploads/2018/09/FINAL-2018-Climate-Scorecard-1.pdf>.

42 For example, see "100 Most Overpaid CEOs," showing asset manager opposition to the worst-ranked CEO pay packages. Weaver, R. 2019. *As You Sow*. 100 Most Overpaid CEOs, Figure 4. <https://www.asyousow.org/report/the-100-most-overpaid-ceos-2019>.

43 For examples, see: 1. Davis, G. and Kim, E.H. 2005. "Would Mutual Funds Bite the Hand that Feeds Them?" *Business Ties and Proxy Voting*. Feb. 15, 2005. <https://ssrn.com/abstract=667625>. 2. Ashraf, R.; Jayaraman, N.; Ryan, H. 2010. "Do Pension-Related Business Ties Influence Mutual Fund Proxy Voting? Evidence from Shareholder Proposals on Executive Compensation." Nov. 23, 2010. <https://ssrn.com/abstract=1351966>. 3. Cvijanovic, D.; Dasgupta, A.; Zachariadis, K. 2016. "Ties that Bind: How Business Connections Affect Mutual Fund Activism." *Journal of Finance*. March 22, 2016. <https://ssrn.com/abstract=2317212>.

44 Iliev, P. and Lowry, M. 2014. "Are Mutual Funds Active Voters?" *Review of Financial Studies*. April 15, 2014. <https://ssrn.com/abstract=2145398>.

The explanation provided by the asset managers themselves is that engagement is their preferred mode of influence, with voting against management reserved as a last resort. They argue that the success of engagements depends on a long-term relationship, and adversarial voting could undermine gains made through cooperative dialogue. Furthermore, dialogue allows asset managers to work with management to achieve nuanced solutions to complicated problems, where shareholder resolutions are considered to be a “blunt instrument.”⁴⁵

A question that is repeatedly raised in response to the “engagement first” strategy is: Why not use active voting and active engagement in tandem? Many of the shareholder resolutions that the Big Three fail to support are backed by a strong proportion of shareholders, including other large asset managers. Engaging company-by-company means that each asset manager is able to reach only a small portion of their entire portfolio in a single year; whereas a vote is a public signal that could scale this reach and signal a heightened level of urgency about important ESG concerns. Given the slow pace of corporate response to intractable and urgent investment risks like climate change, influence via engagement would likely be expedited by active voting. Furthermore, because engagement is not easily observable and is also costly, asset managers are incentivized to underinvest in engagement.

One explanation is that growing influence over vote outcomes, and the difficulty of representing the disparate preferences of a broad base of investors, makes progressive voting on ESG issues potentially contentious and could invite public and political backlash, where vested interests are able to mobilize popular retaliation. These institutions may therefore choose to engage out of the public spotlight.⁴⁶

A case in support of this explanation is the attack on asset-manager voting rights by a lobby group called the Main Street Investors Coalition, which is backed by industry trade associations—the National Association of Manufacturers and the American Council for Capital Formation. Soon after it was launched in 2018, this group took issue with BlackRock and Vanguard’s support for the two-degree climate policy scenario disclosure resolution that won 62% shareholder support at Exxon Mobil XOM and 67% support at Occidental Petroleum OXY in 2017.⁴⁷ This lobby group viewed these proposals as political, and votes in support by BlackRock and Vanguard as contradicting the interests of fund investors. The group has been vocal in lobbying the SEC for restrictions on shareholder resolution filing and on asset-manager voting rights.⁴⁸

Another explanation for limited use of the proxy is that passive voting is cheaper than active voting, and passive fund providers are under much stronger pressure than active managers to keep fund fees low:

⁴⁵ The Investment Stewardship Ecosystem, page 14.

⁴⁶ Bebchuk, L. and Hirst, S. 2019. “Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy.” *Columbia Law Review*. Vol. 119. <https://ssrn.com/abstract=3282794>. See also: The New Permanent Universal Owners.

⁴⁷ Sorkin, A. 2018. “What’s Behind a Pitch for the Little-Guy Investor? Big Money Interests.” *The New York Times*. July 24, 2018. <https://www.nytimes.com/2018/07/24/business/dealbook/main-street-investors-coalition.html>.

⁴⁸ For example, see: Kalt, J., and Turki, A. 2018. National Association of Manufacturers. “Political, Social, and Environmental Shareholder Resolutions: Do They Create or Destroy Shareholder Value?,” page 53. June 2018. <https://mainstreetinvestors.org/wp-content/uploads/2018/06/ESG-Paper-FINAL.pdf>.

The cost-sensitivity of index funds limits their capacity to monitor. This explanation is supported by research finding that index funds are significantly more likely than actively managed funds to side with management and abstain from voting on contentious corporate-governance votes, and that this tendency is even stronger for index funds with lower expense ratios.⁴⁹

For the fund investor trying to understand how their retirement savings are being stewarded, voting is observable. The SEC's N-PX disclosure regime requires fund-by-fund, vote-for-vote disclosures. It is more challenging, however, to evaluate the extent and impact of engagement activities undertaken by asset managers. These are conducted via private dialogue and engagement disclosures generally do not provide details about the contents and outcomes of all engagements undertaken. Consequently, there is far less research addressing how much passive asset managers are investing in engagements and how effective these engagements are in addressing ESG concerns. Yet, there is an emerging model for collaborative engagement that could amplify the efforts of investors by making engagement efforts more observable to coalition members, and by signaling a commitment to a collective escalation response when companies fail to change their governance practices.

The Power of Investor Coalitions has Grown

While engagement and voting allow asset managers to influence companies on their own, investor coalitions are increasingly important in shaping the context within which large asset managers exercise their control rights of ownership. While the largest asset managers have, in the past, not participated in coordinated, issue-focused investor stewardship action, collective action by investors is driving the global investor stewardship movement and coalitions have played an important role in articulating the investor case for addressing ESG risks, such as human rights,⁵⁰ plastic pollution,⁵¹ the opioid crisis,⁵² board diversity,⁵³ and corporate political influence.⁵⁴ All of these networks count asset managers in their membership.

Investor coalitions provide supportive environments enabling members to amplify the impact of their advocacy, engagement, and shareholder resolution filing efforts by sharing resources, such as research, and spreading the workload, such as writing and filing shareholder resolutions and engaging corporate management, while providing a unified voice representing a collective of shareholders.

In 2015, institutional investors from Europe, North America, and Australia formed an investor coalition to co-file shareholder resolutions at BP, Statoil (now called Equinor), and Shell RDS.A calling for "Strategic Resilience for 2035 and Beyond." This coalition, called "Aiming for A," used a combination of

49 Heath, D.; Macciocchi, D.; Michaely, R.; and Ringgenberg, M. C. 2019. Do Index Funds Monitor? Swiss Finance Institute Research Paper No. 19-08. July 6, 2019. <https://ssrn.com/abstract=3259433>.

50 For example, see: Investor Alliance for Human Rights. 2019. <https://investorsforhumanrights.org/>.

51 For example, see: McKerron, C. 2018. "As You Sow Launches Investor Alliance to Engage Companies on Plastic Pollution." *As You Sow*. June 14, 2018. <https://www.asyousow.org/blog/2018/6/14/as-you-sow-launches-investor-alliance-to-engage-companies-on-plastic-pollution>.

52 For example, see: United Automobile Workers Retiree Medical Benefits Trust. 2017. Investors for Opioid Accountability (established July 2017). <http://uawtrust.org/IOA>.

53 For example, see: Thirty Percent Coalition. 2011. <https://www.30percentcoalition.org/>.

54 For example, see: Corporate Reform Coalition. 2019. Policy Solutions. <https://corporatereformcoalition.org/policy-solutions>.

engagement and shareholder resolution filing to secure the support of management of all three oil and gas company targets in 2015. In 2016, the coalition secured the support of management of three global mining companies: Anglo American AAL, Rio Tinto RIO, and Glencore GLEN. When a similar request was filed at Exxon Mobil in 2017, calling on the company to disclose its portfolio resilience under a two-degree policy scenario, 62% of shareholders opposed the board's "against" vote recommendation and supported the resolution. This historic 2017 vote and two similar vote outcomes—at Occidental Petroleum and PPL PPL —marked the first time that the largest asset managers, BlackRock and Vanguard, had opposed management on climate-related shareholder resolutions and, arguably, marked a new chapter in investor advocacy.

The Climate Action 100+ initiative was launched in December 2017 at the inaugural One Planet Summit, by overlapping groupings of investors that had been part of the Aiming for A coalition and the Ceres Action on Carbon Asset Risk Initiative, leveraging the leadership of the PRI.⁵⁵ It is the largest-ever coalition of investors with a stewardship agenda representing a combined \$33 trillion in AUM. In addition to many of the largest public pension funds around the world, like Japan's Government Investment Pension Fund, the Dutch ABP, AustralianSuper, and California Public Employees' Retirement System, the coalition also counts among its members a broad base of global asset managers, including the largest European asset managers.⁵⁶ Following a five-year plan, it trains the engagement activity of members on the world's systemically important emitters of GHGs, providing a structured and organized collective stewardship strategy. It aims to improve climate governance, reduce emissions, and advance climate risk disclosures at targeted companies in line with TCFD recommendations—the global standard for disclosing climate-related financial risk. Sub-groupings of members have used engagement and shareholder resolution filings to secure agreements from large European oil and gas companies Shell, Equinor, and Glencore for setting GHG emission reduction goals and capping coal production. A resolution filed by CA100+ members at BP in 2019 secured board support for stricter carbon reduction targets and commitments to link executive pay to these targets.⁵⁷

This and other collaborative Investor-driven initiatives are extending the stewardship reach of investment fiduciaries and driving a global escalation in stewardship addressing ESG risk.

Policy Can Play a Role in Promoting More-Active Ownership by Passive Managers

Both investors and companies have become more vocal about the urgency of responding to climate change risks and about the investment opportunities engendered in a low-carbon transition. With global scientific consensus that the window of opportunity to act to avoid climate catastrophe is closing rapidly, what policy approaches would encourage and enable the most powerful asset-management institutions to step up their stewardship programs and use their voting power?⁵⁸

55 Climate Action 100+. 2017. <http://www.climateaction100.org/>.

56 Climate Action 100+. 2017. Investors. <https://climateaction100.wordpress.com/investors/>.

57 Holder, M. 2019. "Unprecedented": Why BP investors holding billions in shares are backing a climate resolution." *GreenBiz*. May 20, 2019. <https://www.greenbiz.com/article/unprecedented-why-bp-investors-holding-billions-shares-are-backing-climate-resolution>.

58 IPCC, 2018: Global Warming of 1.5°C. An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty [V. Masson-Delmotte, P. Zhai, H. O. Pörtner, D. Roberts, J. Skea, P.R. Shukla, A. Pirani, W.

Based on a review of the available research literature and an analysis of policy and institutional developments, we view regulatory and stewardship code provisions in the U.S. and the EU, aimed at improved engagement transparency and increasing asset manager participation in investor collaborations, as important for encouraging more-active ownership by the largest passive asset managers to address ESG risks with potentially systemic impacts.

Transparency allows for closer scrutiny of engagement activities. This is especially important where engagement is offered as the primary stewardship strategy. Bebchuck and Hirst argue that bringing greater transparency to asset managers' private engagements would improve the efficacy of engagements in at least two ways: It would communicate material information to all investors, thereby informing others' engagement and voting decisions and extending the impact of the engagement, and it would allow fund investors to evaluate impact, thereby sharpening the focus of engagement efforts on measurable outcomes.⁵⁹ Furthermore, engagement transparency would address concerns about asset managers passing sensitive information between investee companies, which have been raised in the debate around the "common ownership" impacts of the rise of passive investing.

As has already been pointed out, the Big Three asset managers have increased their engagement efforts from year to year over the past few years, and engagement reports show that they are addressing ESG risks in their dialogues with investee companies. They are also incrementally increasing their voting support for ESG resolutions placed on proxy ballots by shareholders. However, academic research and voting surveys by investor groups shows that active voting by the Big Three continues to lag many other providers of index and managed funds.

While the Big Three regard engagement as their primary stewardship strategy, available disclosures do not provide sufficient information for fund investors to judge whether it can be counted as an alternative to active voting—especially where supporting shareholder requests for improved risk disclosures or voting against board members and compensation arrangements could accelerate the governance changes required to address urgent and systemic investment risks. Engagements are typically conducted in private. Some degree of transparency about progress on specific engagements and expected timeframes for achieving impact would hold asset managers accountable for actively voting against management where engagements stall or fail and, likely, would increase competition between fund providers for active ownership services.

With the growing importance of engagement activity as a mode of stewardship, investors need greater transparency into how these activities are conducted and how stewardship strategies integrate proxy voting, engagement, and collaboration with other investors to maximize impact.

Moufouma-Okia, C. Péan, R. Pidcock, S. Connors, J. B. R. Matthews, Y. Chen, X. Zhou, M. I. Gomis, E. Lonnoy, T. Maycock, M. Tignor, T. Waterfield (eds.)). <https://www.ipcc.ch/sr15/>. See also: *Finance UNEP Initiative. 2010. Changing Course*. May 10, 2010. <https://www.unepfi.org/news/industries/investment/changing-course-unep-fi-and-twenty-institutional-investors-launch-new-guidance-for-implementing-tcfd/>.

59 Index Funds and the Future of Corporate Governance, page 72.

When investors hold a shared position on important ESG risks, collaboration via formal investor alliances offers several advantages over acting independently. By coordinating monitoring, engagement, and shareholder resolution filing efforts across global groupings of investors, investor coalitions reduce the costs of stewardship and allow for the strategic deployment of resources. By collectivizing investor voting power (often represented as the total AUM of investors belonging to a coalition), investor coalitions amplify investor voice. By bringing together asset owners and asset managers, well-structured investor collaborations align more closely with the interests of end investors. By joining formal investor collaborations with clear objectives, individual members can credibly signal a commitment to a course of escalation—such as voting against management or even divesting, where possible. Furthermore, organized investors can collectively lobby for policy changes that address systemic financial risks, such as decision-useful climate risk disclosure requirements. Collective engagement also has the advantage of bringing additional scrutiny and transparency to stewardship actions.

Collaboration is endorsed as an effective stewardship strategy by recent code updates. For instance, Principle #4 of the revised EFAMA Stewardship Code states “[A]sset managers should consider acting with other investors, where appropriate, having due regard to applicable rules on acting in concert.”⁶⁰

Moreover, protocols for board-shareholder dialogue have evolved to make collaborative engagements more effective and to address concerns that asset managers might be perceived as acting in concert or sharing inside information.⁶¹ Strampelli (2018) argues that these frameworks address the structural collective action problem frequently cited in the academic literature as a reason for suboptimal investment in engagement activities.⁶²

The effectiveness of collaborative ESG-themed global investor action in addressing systemic risks has been demonstrated by the CA100+ initiative. The Big Three are not members of this initiative; they have instead addressed climate risk independently with their investee companies. While they are large enough to have significant influence acting independently, coordinating the Big Three’s efforts with a broad coalition would accelerate the governance changes that investors expect of the highest emitting companies in the transition to a low-carbon economy.

Conclusions

All financial stakeholders benefit when investors are vigilant about corporate governance. How the most powerful financial industry players exercise their control rights as stewards of capital has important implications for the health of capital markets.

⁶⁰ Principles for asset managers’ monitoring of, voting in, and engagement with investee companies. European Fund and Asset Management Association. 2017. EFAMA Stewardship Code, page 7 (revised 2017-18).
https://www.efama.org/Publications/Public/Corporate_Governance/EFAMA_Stewardship_Code.pdf.

⁶¹ See, for instance, SDX Protocol, (The Shareholder-Director Exchange. 2014. Introduction and Protocol. February 2014. http://www.shareholderforum.com/access/Library/20140200_SDX.pdf) and The Investor Forum’s Collective Engagement Framework. August 2019. (<https://www.investorforum.org.uk/wp-content/uploads/securepdfs/2019/09/CEF-Summary-2019-Update-FINAL.pdf>).

⁶² Strampelli, G. 2018. "Are Passive Index Funds Active Owners? Corporate Governance Consequences of Passive Investing." San Diego Law Review, 2018; Bocconi Legal Studies Research Paper No. 3187159. <https://ssrn.com/abstract=3401620>.

Passive investing is reshaping both the asset-management industry and the structure of corporate shareholding. A parallel trend to the shift to passive investing is the rising demand for sustainable investment products. Index providers and funds are increasingly incorporating ESG principles into portfolio construction and management, and the volume of assets flowing into ESG funds continues to grow.

A growing body of academic literature explores whether passive investing can lead to stronger investor oversight. On the one hand, passive investors face cost pressures and are incentivized to limit spending on stewardship activities. They also may face political or business backlash for publicly opposing corporate management. On the other hand, given their commitment to hold index constituents, they are exposed to systemic risks and can leverage their size to mitigate these risks through direct influence.

Academic proponents of the latter position point out that large providers of passive investment vehicles are motivated to take a long-term, systemic view of investment risk and compete with other providers of low-cost investment strategies on the quality of stewardship services. They have the power to shape public company governance and steer economic activity toward more sustainable business models. This power derives from the votes that they control.

Environmental, social, and governance considerations are increasingly factoring into investor engagements and, by their own account, the largest asset managers prefer engagement, or dialogue, with investee companies over proxy voting as a tool for achieving governance outcomes. While engagement is a potentially powerful tool, unlike proxy voting, it is difficult to observe and link to measurable outcomes.

Where asset managers rely on engagement as a primary strategy, end investors need to be able to gauge the impact of private dialogues and understand how proxy voting is used where engagement fails to achieve objectives within acceptable timeframes. We argue that improved transparency around engagement activities and a well-defined framework for global investor engagement collaboration offer policy strategies for encouraging stronger stewardship on systemic ESG risks.

Appendix

Appendix 1 Stewardship Disclosure Expectations: Selected Examples From Around the World

Country / Membership	Name of Code	Inception Date	Stewardship Code (Y/N)	Requirements Regarding Voting Disclosure	Requirements Regarding Engagement Disclosure	Binding versus Voluntary
Australia	The Financial Services Council Standard 23: Principles of Internal Governance and Asset Stewardship ¹	2017	No	<ul style="list-style-type: none"> ▶ Voting policy and material changes to voting policy 	<ul style="list-style-type: none"> ▶ Engagement with company management and the board, and escalation of issues in instances where initial engagements have not been adequately responded to ▶ Approach to considering ESG factors (risks and opportunities), and whether these considerations influence investment decision-making and company engagement ▶ Collaborative engagement with other investors including involvement with industry groups and associations ▶ Principles used for policy advocacy, including participation with industry groups and associations ▶ The approach to client engagement, education, and communication regarding asset stewardship 	Binding
Canada	Stewardship Principles ²	2010	No	<ul style="list-style-type: none"> ▶ Proxy voting policies or guidelines and how they exercise voting rights ▶ Voting record within a reasonable period of time following a shareholder meeting or as required by law 	<ul style="list-style-type: none"> ▶ Policies on how they intend to engage with investee companies, individually or collaboratively 	Voluntary
European Fund & Asset Management Association	Code of External Governance ³	2018	Yes	<ul style="list-style-type: none"> ▶ On their exercise of ownership rights and voting activities, and have a policy on external governance disclosure. 	<ul style="list-style-type: none"> ▶ Engagement policy and how they exercise their stewardship responsibilities 	Voluntary

[1] Australian Financial Services Council FSC Standard 23: Principles of Internal Governance and Asset Stewardship at State Street Global Advisors, July 2017.
<https://www.fsc.org.au/web-page-resources/fsc-standards/1522-23s-internal-governance-and-asset-stewardship>.

[2] Canadian Coalition for Good Governance Principles for Governance Monitoring, Voting and Shareholder Engagement revised in 2017.
https://www.ccg.ca/wp-content/uploads/2019/03/stewardship_principles_public-1-1.pdf.

[3] European Fund and Asset Management Association Code for External Governance. Revised in 2018.
https://www.efama.org/Publications/Public/Corporate_Governance/EFAMA%20Stewardship%20Code.pdf.

Appendix 1 Stewardship Disclosure Expectations: Selected Examples from Around the World (Continued)

Country / Membership	Name of Code	Inception Date	Stewardship Code (Y/N)	Requirements Regarding Voting Disclosure	Requirements Regarding Engagement Disclosure	Binding versus Voluntary
European Union	Revised Shareholders Rights Directive ⁴	2017	No	<ul style="list-style-type: none"> ▶ On an annual basis, details of how they prepare research, advice and voting recommendations ▶ Investment strategies (for institutional investors and asset managers) 	<ul style="list-style-type: none"> ▶ How engagement is integrated into the investment strategy ▶ On an annual basis, how the policy was implemented including a general description of voting behavior, an explanation of the most significant votes, and the use of the services of proxy advisors ▶ Implementation of their engagement policy and in particular how they have exercised their voting rights ▶ Information explaining how the main elements of their equity investment strategy are consistent with the profile and duration of their liabilities and how those elements contribute to the medium- to long-term performance of their assets ▶ To institutional investors the composition, turnover, and turnover costs of their portfolio; as well as their policy on securities lending 	Binding
International Corporate Governance Network	Statement of Principles on Institutional Shareholder Responsibilities ⁵	2007	No	<ul style="list-style-type: none"> ▶ On a regular basis, their actual voting records publicly on their website as well as directly to clients. Voting records should indicate whether resolutions were cast for, against or abstained. ▶ The extent to which they use proxy research and voting services, including the identity of the provider and the degree to which any recommendations are followed. ▶ Their approach to stock lending and voting in a clear policy, which should clarify the types of circumstances where shares would be recalled to vote, and how stock lending of individual shares may have affected voting activity. 	<ul style="list-style-type: none"> ▶ Publicly, their stewardship policies—preferably on their website and, in a “comply or explain” context—should provide meaningful explanations regarding aspects of the stewardship code that the investor does not comply with. ▶ To their beneficiaries or clients, their key internal governance arrangements in order to be held effectively accountable for exercising stewardship duties on their behalf. 	Voluntary
South Africa	Code for Responsible Investment in South Africa (CRISCA) ⁶	2011	Yes	<ul style="list-style-type: none"> ▶ Proxy vote results, which includes direct disclosure of vote results per resolution; whether the vote cast by the institutional investor or its service provider was against or where it abstained from voting; an explanation of the reasons where it abstained or a vote was cast against the proposed resolution; whether the meeting was attended by the institutional investor or whether voting took place by proxy 	<ul style="list-style-type: none"> ▶ Summary of engagement activities in a manner consistent with the institutional investor’s responsible ownership policy, with details on the nature and number of engagements, and otherwise including the substance of the engagement and progress made 	Voluntary—Apply or explain basis

[4] European Union. The Shareholder Rights Directive II. 2017 Official Journal of the European Union. May 17, 2017. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017L0828&from=EN>.

[5] International Corporate Governance Network Global Stewardship Principles. Revised 2016. <http://icgn.flpbks.com/icgn-global-stewardship-principles>.

[6] Institute of Directors Southern Africa. 2011. Code for Responsible Investment in South Africa. <https://www.iodesa.co.za/page/CRISACode> (CRISCA Code).

Appendix 1 Stewardship Disclosure Expectations: Selected Examples from Around the World (Continued)

Country / Membership	Name of Code	Inception Date	Stewardship Code (Y/N)	Requirements Regarding Voting Disclosure	Requirements Regarding Engagement Disclosure	Binding versus Voluntary
United Kingdom	The UK Stewardship Code ⁷	2010	Yes	<ul style="list-style-type: none"> ▶ Periodic reports on stewardship and voting activities ▶ Voting records ▶ Use made, if any, of proxy voting or other voting advisory services 	<ul style="list-style-type: none"> ▶ How they will discharge their stewardship responsibilities ▶ A robust policy on managing conflicts of interest in relation to stewardship ▶ Their approach to stock lending and recalling 	Voluntary—Comply or explain basis
United States	Investor Stewardship Group Stewardship Framework for Institutional Investors ⁸	2017	Yes	<ul style="list-style-type: none"> ▶ The extent to which the fund delegates its proxy voting decisions to its recommendations of a third party ▶ Policies and procedures relating to matters that may affect substantially the rights or privileges of the holders of securities to be voted ▶ Policies regarding the extent to which the fund will support or give weight to the views of management of a portfolio company 	<ul style="list-style-type: none"> ▶ How they manage potential conflicts of interest that may arise in their engagement activities 	Voluntary

[7] Financial Reporting Council UK Stewardship Code. Revised in 2012. <https://www.frc.org.uk/investors/uk-stewardship-code>.

[8] Investor Stewardship Group Stewardship Framework for Institutional Investors. 2017. <https://isgframework.org/stewardship-principles/>.

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