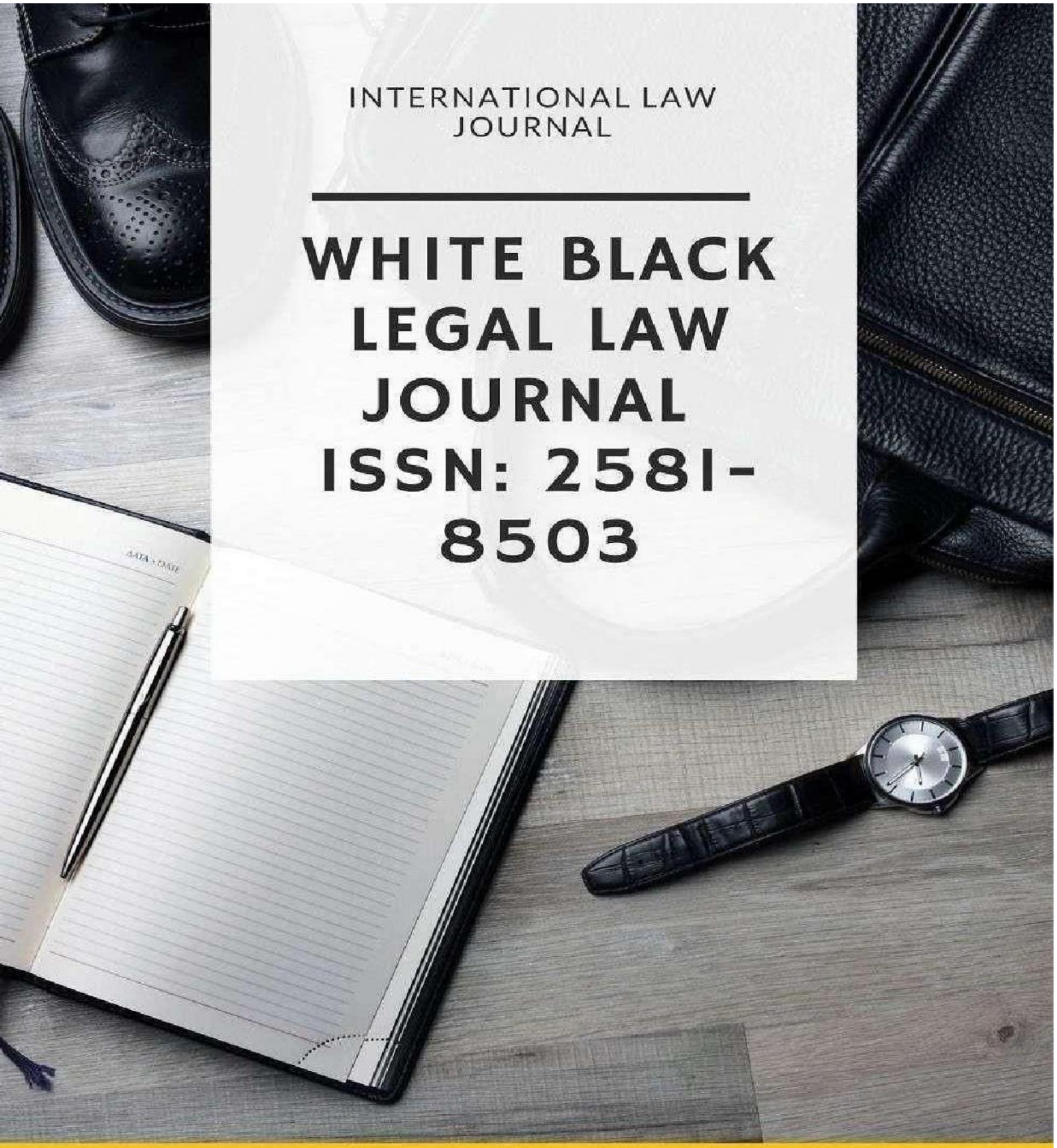


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THE ROLE OF INSTITUTIONAL INVESTORS IN SHAPING CORPORATE GOVERNANCE: STEWARDSHIP CODES AND THEIR ENFORCEABILITY

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Abstract

Major investors like pension funds, mutual funds, and insurance companies now own most of the shares in big companies. To get these investors to keep a close eye on how companies are run, something called stewardship codes was created. The problem is, these codes are not really enforceable. This article looks at how different countries - like the UK, Japan, the EU, India, and the US - regulate stewardship. It checks if simply asking companies to "comply or explain" or "apply and explain" is enough to hold them accountable, even if there are no legal consequences. The article says that just having voluntary or mandatory rules is not enough. Instead, it suggests a mixed approach. This would mean that companies have to follow basic rules that can be checked by independent auditors, especially when it comes to conflicts of interest and how they vote on important issues. At the same time, companies would still have some freedom to decide how they want to handle other aspects of stewardship.

Keywords: institutional investors; stewardship codes; corporate governance; comply-or-explain; enforceability; SEBI; passive investing.

1. Introduction

Over most of the 20th century, academics debated corporate governance through the Berle-Dodd debate; whether corporations should be run for the benefit of all shareholders or for the benefit of only some. At that time, most shareholders were individual investors who were disorganized and passive. This situation is no longer the case. Now institutional investors such as asset managers, pension funds, insurance companies, and even sovereign wealth funds are the largest group of shareholders in major markets worldwide. Institutional investors have been able to purchase blocks of shares in companies that allow them to make voting and engagement decisions that can affect a company's strategic direction.

At the core of contemporary corporate governance, this concentration poses a conundrum. The traditional agency dilemma between scattered shareholders and self-interested managers was supposed to be resolved by institutional investors since they have the scale, resources, and experience to oversee management in a manner that ordinary shareholders cannot. However, because they represent pensioners, insurance policyholders, and fund unit holders, institutional investors have their own agency expenses. An asset manager competing on fee margins has little motivation to devote resources in engagement when the advantages of working with a portfolio firm are distributed among all shareholders and the costs are solely borne by the engaging investor.[1]

In order to address this second-order agency issue, stewardship codes were created. In reaction to the 2008 financial crisis, when many observers believed that "absentee" institutional shareholders had failed to curb excessive risk-taking by bank boards, the UK implemented the first such policy in 2010.[2]

Since then, similar regulations have been introduced by jurisdictions all over the world, instructing institutional investors to keep an eye on, interact with, and raise concerns regarding the businesses they participate in. In 2014, Japan came next.[3] In 2017, the EU established a baseline requirement in the Shareholder Rights Directive II (SRD II).[4] Insurance companies, pension funds, mutual funds, and alternative investment funds were subject to sector-specific stewardship regulations in India between 2017 and 2020.[5]

While it is clear that codes of stewardship exist and have become widespread, the more important question is whether they are effective. A regulatory system based around a 'comply or explain' or 'apply and explain' framework does not guarantee that institutional investors will behave differently as intended by the code. The problem here is that regulators increasingly see stewardship codes as a replacement to more intensive regulatory measures such as

[1] Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. Econ. Persp. 89 (2017).

[2] Sir David Walker, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities: Final Recommendations* (Nov. 26, 2009); Fin. Reporting Council, *The UK Stewardship Code* (July 2010) [hereinafter FRC, *2010 Code*]; *see also* John Kay, *The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report* (July 2012).

[3] Council of Experts on the Stewardship Code, Fin. Servs. Agency (Japan), *Principles for Responsible Institutional Investors ≪Japan's Stewardship Code≫* (Feb. 2014).

[4] Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 Amending Directive 2007/36/EC as Regards the Encouragement of Long-Term Shareholder Engagement, 2017 O.J. (L 132) 1 [hereinafter SRD II].

[5] Umakanth Varottil, *Shareholder Stewardship in India: The Desiderata* (NUS Law Working Paper No. 2020/005, NUS Ctr. for Asian Legal Stud. Working Paper No. 20/01, Feb. 2020), https://law.nus.edu.sg/wp-content/uploads/2020/05/005_2020_Umakanth.pdf; Sec. & Exch. Bd. of India, Circular No. CIR/CFD/CMD1/168/2019, *Stewardship Code for All Mutual Funds and All Categories of AIFs in Relation to Their Investment in Listed Equities* (Dec. 24, 2019) [hereinafter SEBI Circular].

mandatory say on pay regimes, statutory fiduciary duties for asset managers and direct penalties. If stewardship codes are seen largely as a token gesture (as argued by critics) this may lead to an under regulation issue leaving there to be significant governance issues.

1.1 Method, scope and contribution

The article is structured around doctrine and comparative analysis of the key instruments of corporate stewardship plus the secondary literature. The five countries have been chosen to represent different approaches to enforcing corporate stewardship. Both the UK and Japan enforce a type of soft law, the EU enforce a minimum statutory standard, in India it is enforced in a sector specific manner and finally there is no official code in the US. The article has eight sections. Section two provides an overview of the theory and principles behind corporate stewardship. Section three compares the stewardship codes of the UK, Japan, EU, India and the US plus globally. Section four considers the issues surrounding enforceability and an analysis of the strengths and weaknesses of comply or explain. Section five looks at some of the special issues surrounding common ownership and passive investment. Section six considers the evidence surrounding successful and unsuccessful corporate stewardship. Section seven looks at recommendations for reform and section eight concludes.

2. Conceptual and Theoretical Foundations

2.1 From Ownership to Stewardship

Stewardship has been specifically used to move away from simply using voting rights at general meetings. Usually stewardship regulations define stewardship as 'responsible investment'. This involves using capital in a way that creates long-term value for clients and beneficiaries whilst considering economic, environmental and social factors. This can be seen with the UK Stewardship Code 2020. It moves away from traditional ownership and focuses on the investor relationship with the investee company.[6]

There are three main theories that are applied to support this idea. Agency theory is used to justify the governance role of stewardship. This assumes institutional investors have informational and scale advantages so are best placed to act as monitors for dispersed ultimate shareholders).[7] Secondly the stakeholder (or enlightened shareholder value) theory uses

[6] Fin. Reporting Council, *The UK Stewardship Code 2020*, at 4 (Oct. 2019) [hereinafter FRC, *2020 Code*] (defining stewardship as "the responsible allocation, management and oversight of capital to create long-term value" for clients and beneficiaries).

[7] Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. Fin. Econ. 305 (1976).

stewardship as part of ESG analysis. This involves incorporating ESG factors into investment decision making. This is because how management deals with social and environmental issues will impact on their ability to create long term value for shareholders. Lastly, although less developed there is a systemic risk theory. This means investors should consider systemic risk as well as individual risk. Since the 2008 crisis this has become increasingly important. It aims to encourage responsible behaviour considering the systemic risk caused by the pro-cyclical herding of institutional investors..

2.2 The Agency Problem, Twice Removed

Following Adolf Berle and Gardiner Means, classical corporate law scholarship identifies the separation of ownership and control as the defining weakness of the modern public corporation: dispersed shareholders lack both the capacity for collective action and the incentive to monitor professional managers effectively. Institutional investors have long been seen as the natural remedy. However, they introduce a second layer of agency costs. Pension fund trustees, mutual fund managers and insurance portfolio managers are agents of ultimate beneficiaries (policyholders, retail unit-holders and pensioners), who have little control over the stewardship decisions made on their behalf.

Conflicts of interest make this worse. An asset manager that also seeks lucrative pension administration or advisory mandates from corporate clients has an obvious motive not to vote against those companies' management on sensitive issues such as executive pay. Stewardship codes address this by requiring disclosure of conflict-of-interest policies. Disclosure alone, however, does not resolve the underlying mismatch of incentives.

2.3 The Free-Rider Problem and the Case for Collective Engagement

Individual institutional investors are disinclined to bear the whole cost of engagement, because the benefits of successful stewardship (a better-governed and better-performing investee company) accrue to all shareholders regardless of their own contribution. This is a textbook collective action problem. Stewardship codes in the UK and, more recently, Japan respond by encouraging collective or coordinated engagement by institutional investors; in Japan's case, the FSA's 2025 consultation proposes to promote it actively. The codes also caution that engagement must not become a box-ticking exercise pursued for its own sake, and must not amount to "acting in concert" for the purposes of takeover regulation.

3. Comparative Survey of Stewardship Codes

3.1 The United Kingdom: The Pioneer Model

The UK Stewardship Code was published by the Financial Reporting Council (FRC) in 2010. This built on an existing industry code and the recommendations of the Walker Review into bank governance.. It was revised in 2012 to clarify the respective roles of asset owners and asset managers, and to encourage more explicit disclosure of how signatories exercise their responsibilities. In its original form, the Code operated on a "comply-or-explain" basis and its principles were framed as aspirational statements.

The 2020 Code, which took effect on 1 January 2020, changed the approach in two important ways. First, it replaced comply-or-explain with "apply-and-explain": signatories must describe how they have applied each principle, with specific examples, rather than simply assert compliance. Second, and perhaps most importantly, it shifted the focus from policy disclosure to reporting on outcomes and effectiveness. Signatories must now show the real results of their stewardship activity, and not only outline their stewardship policies.

Recognising the influence that intermediaries have over voting outcomes, especially in index and quantitative strategies, the 2020 Code also extended its principles beyond asset managers and asset owners to service providers, including proxy advisers and investment consultants. Importantly, however, the FRC does not independently verify the accuracy of signatories' disclosures. It reviews reports for evidence of genuine adherence to the Code's principles, but it has no power to penalise a signatory whose stewardship is inadequate. A signatory whose report is inadequate may lose its signatory status, which is a reputational rather than a legal sanction.

3.1A The 2026 Code: From Disclosure Towards Value Creation

The FRC published a further revision, the UK Stewardship Code 2026, on 3 June 2025, to take effect on 1 January 2026.[8] It does not abandon the 2020 model. It simplifies it, and the changes bear directly on the enforceability question.

First, the definition of stewardship is reframed around the creation of long-term sustainable value for clients and beneficiaries, with the economy, environment and society as the outcomes that value is meant to serve. This keeps the outcomes orientation introduced in 2020 and makes

[8] Fin. Reporting Council, *UK Stewardship Code 2026* (June 2025), https://media.frc.org.uk/documents/UK_Stewardship_Code_2026.pdf [hereinafter FRC, *2026 Code*]; Press Release, Fin. Reporting Council, FRC Overhauls the Investor Stewardship Code to Focus on Value Creation, Reducing Burdens and Enhanced Engagement Between Market Participants (June 3, 2025), https://frc.org.uk/news-and-events/news/frc-overhauls-the-investor-stewardship-code-to-focus-on-value-creation-reducing-burdens-and-enhanced-engagement-between-market-participants.

it the organising idea of the Code.

Second, the reporting architecture is lighter. The Code has fewer principles than its predecessor, and the Policy and Context Disclosure is now due once every four years rather than annually, while the Activities and Outcomes Report remains the regular report. The FRC has stated that early evidence suggests signatories can reduce reporting volume substantially while maintaining quality. 2026 is a transition year in which existing signatories were not to be removed from the list on the basis of their 2026 application.

Third, the Code's reach has widened. It contains dedicated principles for asset owners and asset managers and, for the first time, for proxy advisers, investment consultants and engagement service providers, reflecting the influence that intermediaries have over voting outcomes. At the time of publication, the FRC reported nearly 300 signatories managing about £50 trillion in assets.

For the argument of this article, the 2026 revision is significant in what it does not do. It reduces reporting burdens and sharpens the focus on outcomes, but it introduces no independent verification of signatories' reports and no sanction beyond loss of signatory status. The FRC's own account of the reform emphasises burden reduction and quality of engagement, not stronger enforcement. The revision therefore confirms the central claim of this article: the UK, as the pioneer jurisdiction, is refining the narrative, outcomes-based disclosure model rather than moving towards assurance or binding sanction. Whether lighter reporting will raise or lower the credibility of the regime is an empirical question to which the evidence is not yet available.

The UK regime also has a binding element that sits outside the Code and should be noted. The FCA's Conduct of Business Sourcebook requires authorised asset managers to publish the nature of their commitment to the Code or an explanation of their alternative approach (COBS 2.2.3R), and COBS 2.2B implements the SRD II engagement-policy duties. Trustees of occupational pension schemes must also state their stewardship policy in their statement of investment principles and report on its implementation. The UK model is therefore best described as a voluntary code with a thin regulatory perimeter around it, not as pure soft law.

3.2 Japan: Soft Law with State Encouragement

Signatories grew from a small base to 280 institutional investors by March 2020 and 344 by 30 June 2025, comprising 214 investment managers, 87 pension funds, 25 insurers, six trust banks

and 12 others[9]

The Code was part of a wider programme of corporate governance reform in the "Abenomics" era, which also included a separate Corporate Governance Code for listed companies. Signatories grew from a small base to 280 institutional investors by March 2020.

The 2020 revision expanded disclosure requirements for investment managers and, for the first time, added sustainability and ESG factors to the definition of stewardship responsibilities. It also covered asset owners such as corporate pension funds, and service providers such as proxy advisers. Japan's approach to ESG integration is more instrumental than the UK's: rather than treating ESG as a stand-alone stewardship goal, the Code requires that sustainability considerations be consistent with an institutional investor's investment management strategy.

The FSA completed its third revision of the Code in June 2025, following a public consultation.[10] The revision responds to growth in passive investment and to uncertainty among investors about when collaborative engagement could cause them to be treated as "joint holders" under the large shareholding reporting rule. It clarifies the scope of "joint holders" to facilitate collaborative engagement, and clarifies the meaning of "act of material proposal" so that investors can pursue in-depth dialogue with investee companies without being drawn into the reporting regime. These clarifications operate alongside amendments to the Financial Instruments and Exchange Act that take effect on 1 May 2026. The Japanese experience supports Recommendation 5 of this article: the main obstacle to collective stewardship is legal uncertainty about the boundary of "acting in concert", and the regulator's response has been to provide legal guidance rather than to tighten the Code's sanctions. The Code itself remains non-binding.

3.3 The European Union: A Statutory Floor

With SRD II (Directive 2017/828), the EU took a significantly different, legislative route. Member states were required to incorporate a baseline obligation into national law by mid-2019: asset managers and institutional investors must develop and publicly disclose an engagement policy explaining how they integrate shareholder engagement into their investment strategy, or explain why they have chosen not to do so. Unlike the UK and Japanese codes, which are non-statutory instruments issued by a regulator, the engagement-policy provision of SRD II is binding law in every member state.

[9] Fin. Servs. Agency (Japan), *Institutions That Have Accepted Japan's Stewardship Code* (list as of June 30, 2025), https://www.fsa.go.jp/en/refer/councils/stewardship/20160315.html [hereinafter FSA, *Signatory List*] (reporting 344 institutional investors as of June 30, 2025).

[10] Fin. Servs. Agency (Japan), *Principles for Responsible Institutional Investors ≪Japan's Stewardship Code≫* (Third Revised Version) (June 26, 2025), https://www.fsa.go.jp/en/refer/councils/stewardship/20250626.html.

The content of the obligation, however, is a comply or explain disclosure duty rather than a prescriptive substantive standard. UK signatories complying with the UK Stewardship Code are generally understood also to satisfy SRD II's disclosure obligation, because the Code's principles go beyond the directive's baseline. This shows how voluntary codes and statutory minimum standards can operate together in a layered, complementary way.

3.4 India: Mandating What Others Leave Voluntary

India is the most instructive comparative case, because its regulators departed from the global "comply-or-explain" consensus. India built a sector-by-sector architecture of stewardship regulation covering insurers, pension funds, mutual funds and alternative investment funds (AIFs). It began with the Insurance Regulatory and Development Authority of India (IRDAI) stewardship guidelines in 2017, followed by the Pension Fund Regulatory and Development Authority (PFRDA) code in 2018, and concluded with the Securities and Exchange Board of India (SEBI) circular of December 2019. The SEBI circular took effect for the fiscal year beginning 1 April 2020, and was later deferred to July 2020 because of COVID-19. The SEBI and PFRDA frameworks go further than the IRDAI's comply-or-explain approach: compliance is obligatory, not optional, for mutual funds and AIFs investing in listed equities.[11]

This is a significant doctrinal shift. The UK and Japanese codes rely on reputation and voluntary signature. India, by contrast, has turned stewardship duties into binding regulatory obligations, enforceable through SEBI's ordinary supervisory and enforcement powers under the SEBI Act, 1992 and the SEBI (Mutual Funds) and (Alternative Investment Funds) Regulations. Institutional investors must formulate and publish policies on how they will discharge their stewardship responsibilities. Those policies must cover managing and disclosing conflicts of interest, monitoring investee companies, a clear policy on intervention, a policy on collaborative engagement, transparent exercise of voting rights with disclosed reasons, and regular reporting to clients and beneficiaries.

Commentators have nevertheless pointed out that India's stewardship framework remains fragmented across three regulators with slightly different principles, and that there is no single, integrated stewardship code for the institutional investor community as a whole. Indian corporate governance scholars have repeatedly urged regulators to close this gap.

[11] SEBI Circular, *supra* note 5, ¶ 4 (providing that all mutual funds and all categories of AIFs "shall mandatorily follow" the Code in relation to listed equities); *see* Umakanth Varottil, *Shareholder Stewardship Efforts: A Mixed Bag*, BloombergQuint (2020), https://www.bloombergquint.com/amp/opinion/shareholder-stewardship-efforts-a-mixed-bag (noting IRDAI's February 2020 revision from comply-or-explain toward a mandate).

3.5 The United States: Stewardship Without a Code

Unlike the UK, Japan or India, the United States has no formal stewardship code approved or endorsed by the SEC. US institutional investor stewardship is instead governed by a patchwork: fiduciary duty principles under the Employee Retirement Income Security Act (ERISA) for pension plans, state trust law and corporate law fiduciary standards, SEC proxy voting disclosure rules (Form N-PX), and voluntary private codes such as the Investor Stewardship Group's Framework for U.S. Stewardship and Governance.

The absence of a unifying code has not prevented highly influential stewardship practice. The "Big Three" asset managers (BlackRock, Vanguard and State Street) together vote a substantial share of the shares of S&P 500 companies.[12] But it does mean that the terms of engagement, the format of disclosure and the substantive expectations are set unilaterally by each asset manager rather than measured against a common, publicly negotiated standard. This has produced a distinctly American form of the enforceability debate. It focuses less on comply-or-explain mechanics and more on antitrust and "common ownership" concerns,[13] and on political controversy over whether asset managers should use their voting power to pursue ESG objectives at all.

3.6 Global Coordination: The ICGN and Emerging Convergence

The International Corporate Governance Network (ICGN) issued its Global Stewardship Principles to standardise national practice and to guide countries without a domestic code. Even at transnational level, stewardship regulation has favoured soft-law convergence over hard-law harmonisation. The ICGN's principles are voluntary and have no independent enforcement mechanism, although they have influenced the drafting of more recent national codes.

3.7 Summary Comparison

Table 1 summarises the five jurisdictions. The variation in legal status and sanction is the starting point for the enforceability analysis in Part 4.

Table 1: Stewardship regulation in five jurisdictions

Jurisdiction	Main instrument(s)	Issuing body	Legal status and model	Main sanction
United Kingdom	UK Stewardship Code 2020 (first issued 2010)	Financial Reporting Council (FRC)	Voluntary code; "apply-and-explain"	Removal from the signatory list (reputational)

[12] Lucian A. Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. Rev. 721, 736 (2019) (reporting that the Big Three together cast, on average, about 25% of the votes at S&P 500 companies as of 2017).

[13] José Azar, Martin C. Schmalz & Isabel Tecu, *Anticompetitive Effects of Common Ownership*, 73 J. Fin. 1513 (2018); Eric A. Posner, Fiona M. Scott Morton & E. Glen Weyl, *A Proposal to Limit the Anti-Competitive Power of Institutional Investors*, 81 Antitrust L.J. 669 (2017).

Jurisdiction	Main instrument(s)	Issuing body	Legal status and model	Main sanction
Japan	Stewardship Code (2014; revised 2017, 2020)	Financial Services Agency (FSA)	Voluntary "soft law"; comply-or-explain	Reputational only
European Union	Shareholder Rights Directive II (Directive 2017/828)	EU legislature; national transposition	Binding statutory floor: publish an engagement policy or explain why not	National sanctions for non-disclosure
India	IRDAI (2017), PFRDA (2018), SEBI (2019) stewardship codes	Three sectoral regulators	Sectoral; mandatory for mutual funds and AIFs	Ordinary supervisory and enforcement powers of the regulator
United States	No official code; ERISA, Form N-PX, ISG Framework (private)	DOL, SEC; private bodies	Fiduciary law and disclosure; private code is voluntary	None for stewardship quality; disclosure rules enforceable

4. The Enforceability Problem

4.1 Comply-or-Explain: Origins and Rationale

The comply-or-explain model originated in the UK Corporate Governance Code (originally the Cadbury Code, 1992) and was later exported to stewardship codes.[14] It rests on a particular regulatory philosophy. Markets, acting through informed shareholders and reputation, are better placed than regulators to judge whether an explanation for non-compliance is adequate, and governance practices vary too much across firms to be standardised into one-size-fits-all rules. Its main advantages over prescriptive law are flexibility, adaptability to the needs of individual firms and lower direct compliance costs.

The UK Stewardship Code's move to "apply-and-explain" reflects a specific criticism of comply-or-explain in the stewardship setting. A signatory could satisfy the "comply" limb by asserting compliance with the letter of a principle while providing no substantive evidence of activity, because the original principles were framed as aspirational statements (for example, that institutional investors should be willing to act collectively with other investors where appropriate). Apply-and-explain was intended to make signatories support such assertions with specific, demonstrable examples of stewardship activity and outcomes. This is a considerably higher bar. Even so, it still relies on the signatory's own narrative, because the FRC does not independently verify or audit the underlying engagement records.

4.2 The Fundamental Criticism: Box-Ticking and the Lack of Sanction

Comply-or-explain and apply-and-explain regimes are prone to become box-ticking exercises:

[14] Comm. on the Fin. Aspects of Corp. Governance, *Report of the Committee on the Financial Aspects of Corporate Governance* (1992).

signatories produce carefully drafted, principle-referencing disclosure documents that bear little relation to the quality of their actual stewardship. This is the central and perennial criticism of stewardship codes made by academics, regulators and industry bodies. A CFA Institute position paper that surveyed market participants found that about half of respondents thought comply-or-explain was generally appropriate for stewardship codes, but more than a quarter thought the current level of enforcement was ineffective, with clear calls for a regulator to take on an oversight and monitoring role to give the codes more credibility.[15]

The critique has several distinct dimensions.

First, there is no real penalty for misleading or superficial stewardship disclosure. Under both the UK and Japanese models, the worst outcome for a signatory that fails to report adequate stewardship is removal from the signatory list, which is a reputational rather than a legal penalty. For seriously misleading stewardship disclosures there is no equivalent of securities-law liability, no fine and no direction to change conduct. Reputational sanctions operate only if clients, beneficiaries or the media actually scrutinise the disclosure. Most retail pension savers and fund investors lack both the means and the practical ability to compare one asset manager's stewardship report with another's. The disciplining force on which comply-or-explain relies is therefore often too weak to have any effect.

Second, "effectiveness" is difficult to measure. Even the enhanced outcomes-based reporting now required by the UK Code is hard to audit externally, because it is rarely possible to observe or attribute a causal link between an investor's engagement and an improvement in a company's behaviour or performance. A company may reform its CEO pay or board diversity for reasons unrelated to any particular investor's engagement letter, and a reporting signatory can still claim credit for the result without having contributed to it.

Third, conflicts of interest undermine the alignment of incentives. Asset managers often have business ties with the very companies whose management they are supposed to oversee through engagement and voting, as corporate advisers, index licensors or pension administrators. Stewardship codes require disclosure of conflict-of-interest policies, but they do not require structural separation (such as independent voting committees or information barriers), and they do not audit how published policies are actually implemented.

Fourth, there are mismatches of scale and resources, particularly for smaller institutional

[15] Mary Leung, *Stewardship 2.0: Awareness, Effectiveness, and Progression of Stewardship Codes in Asia Pacific* (CFA Inst. Aug. 6, 2020), https://rpc.cfainstitute.org/policy/positions/stewardship (reporting, among respondents in eight Asia-Pacific markets, that 49% believed comply-or-explain provides sufficient oversight and enforcement and that 62% preferred a regulatory body as supporter and overseer of stewardship codes).

investors. Whatever the legal form of the stewardship obligation, firms operating at scale may find that the marginal cost of meaningful stewardship across a large number of small holdings exceeds any plausible private benefit. Commentary on India's stewardship code notes, for example, that alternative investment funds often lack the staff capacity to monitor every investee company effectively.

4.3 Mandatory Compliance: India's Test and Its Boundaries

India's decision to make the SEBI and PFRDA stewardship codes mandatory, rather than comply-or-explain, is often cited as the natural regulatory response to the enforceability criticism. The reasoning is that if disclosure-based reputational pressure is insufficient, compliance can simply be mandated and backed by SEBI's conventional enforcement tools: show-cause notices, penalties and, in extreme cases, suspension of registration.

The Indian example, however, also reveals the limits of this strategy. Mandating the quality of stewardship is a distinct and much harder regulatory problem, because "adequate engagement" and "adequate monitoring" are not inherently justiciable standards in the way that a minimum capital requirement or a disclosure deadline is. Mandating the disclosure of a stewardship policy, by contrast, is simple to enforce: a fund either publishes the required policies or it does not. SEBI's mandatory approach therefore resolves the enforcement problem for the procedural layer of stewardship (do the required policies exist, and are votes disclosed?). The substantive layer (is engagement actually improving governance outcomes?) remains as difficult to assess and enforce as it is under the UK's voluntary model. Any assessment of whether mandatory status alone has produced demonstrably stronger stewardship than the UK's voluntary, reputation-based model is further clouded by India's continuing regulatory fragmentation across IRDAI, PFRDA and SEBI, each of which applies a code with somewhat different content and a different enforcement posture.

4.4 Should Stewardship Codes Be Enforced by Law?

Whether stewardship principles should be converted from soft law into legally binding statutory obligations presents a genuine trade-off, and this article does not claim that there is a single obvious answer.

The EU's SRD II shows that a statutory floor of engagement-policy disclosure is administratively workable and does not appear to have produced excessive litigation or compliance paralysis. Further arguments for binding regulation are the continuing gap between disclosed policy and observed practice, and the weakness of reputational sanctions against large asset managers whose retail clients pay little attention to stewardship performance.

The arguments against binding regulation are as follows:

- Unlike financial statement disclosure, stewardship is hard to reduce to objectively verifiable rules.
- Strict, prescriptive mandates risk producing the same box-ticking exercise that affects voluntary codes, but with legal liability attached.
- A rigid statutory standard cannot accommodate the real diversity of investment strategies, from passive index funds with thousands of small positions to concentrated active managers that can engage meaningfully with a few portfolio companies.
- In the US context in particular, excessive mandatory engagement requirements could expose large asset managers to antitrust liability under a "common ownership" theory, since coordinated engagement by rival asset managers across an industry could be characterised as anti-competitive concerted action.

4.5 A Moderate Approach: Outcome-Focused and Tiered Enforcement

A promising reform option is a tiered enforcement architecture. It would keep a flexible, principles-based standard for those elements of stewardship that cannot truly be verified objectively, and reserve binding legal obligations for those that can. This approach draws on the lessons of the jurisdictions discussed above.

For the procedural layer, following India's approach, three matters would be made mandatory and independently auditable: disclosure of per-resolution voting records, disclosure of conflict-of-interest policies, and disclosure of engagement escalation protocols. These are objectively verifiable facts: a vote either was or was not cast, and was cast in a particular direction, and a policy either exists or it does not.

The qualitative question of whether a particular engagement was "effective" is different. At present it is left to the regulator's largely non-verificatory review of signatories' submissions. It would be better handled through a market-facing, apply-and-explain narrative disclosure regime like the UK's 2020 reforms, but strengthened by independent third-party assurance, analogous to the external audit of financial statements.

5. Common Ownership, Passive Investing and the Limits of Stewardship

No modern discussion of institutional stewardship can avoid the structural problem posed by the sharp rise of passive, index-tracking investment. By design, passive funds own every constituent of an index regardless of firm-specific performance or governance quality. They cannot "exit" a poorly managed company by selling its shares without abandoning the index-

tracking objective. This removes the traditional market discipline of the "Wall Street Walk" and places all accountability on "voice", meaning voting and engagement, which is the very channel that stewardship rules are meant to reinforce.

However, index funds compete mainly on fee minimisation, and any engagement cost that one passive manager incurs benefits all holders of the same index, including lower-cost competitors. Passive managers therefore have the weakest commercial incentive of all to invest in firm-specific engagement.

The result, seen in several jurisdictions, is that a small number of very large asset managers running index strategies have become the largest voting blocks in most listed companies, while devoting relatively small, centralised stewardship teams to thousands of portfolio companies. This scale mismatch cannot be fully resolved by any stewardship code, however well drafted. Resolving it would require either a significant increase in stewardship-team funding, which fee-competitive passive managers are reluctant to provide, or a shift towards collective, cross-manager engagement of the kind promoted by both the UK Code and Japan's 2025 consultation. Such collective action, in turn, raises antitrust and "acting in concert" concerns.

6. Stewardship in Practice: Successes and Limits

The empirical evidence on whether stewardship codes have changed investor behaviour is mixed, but several recurring patterns deserve attention.

6.1 Remuneration Engagement

One of the clearest areas of impact has been say-on-pay and remuneration engagement. In jurisdictions such as the UK, coalitions of institutional shareholders, organised through bodies such as the Investment Association, have often been able to force changes by remuneration committees before formal votes take place. This suggests that the mere prospect of a public vote "against", made more likely by stewardship-code disclosure obligations, influences board behaviour before the vote occurs, even where the vote is only advisory.

6.2 Climate and ESG Engagement

Since the 2020 revisions to the UK and Japanese codes brought sustainability into the definition of stewardship, climate-related engagement has become much more prominent. Several major asset managers have published "escalation" frameworks requiring votes against board chairs at companies judged unresponsive to climate-related shareholder proposals. Critics, however, point to the malleability of stewardship commitments in the face of shifting political and commercial pressure. Examples include state-level "anti-ESG" legislation in the US targeting

asset managers seen as pursuing non-financial objectives with beneficiaries' capital, and the fall in voting support for climate resolutions among some of the largest passive managers in recent proxy seasons.[16]

6.3 Board Independence in Japan

Board composition and independence engagement has produced measurable results in markets such as Japan. There, sustained institutional investor pressure, reinforced by the parallel Corporate Governance Code, has been associated with a significant increase over the past decade in the proportion of listed companies appointing a majority of independent outside directors.[17] Regulators and commentators usually attribute this shift at least partly to stewardship-driven voting pressure rather than to statutory compulsion alone.

6.4 Controlling Shareholders and Emerging Markets

Related-party transactions and minority shareholder protection, on the other hand, remain areas in which stewardship has found it hard to gain traction in several emerging markets, including India, despite the formal rigour of the relevant codes. In these markets, controlling-shareholder structures in a large proportion of listed companies limit the practical influence that even well-resourced institutional minority shareholders can exert through voting or engagement alone.

6.5 What the Pattern Shows

These examples point to a more general conclusion relevant to the enforceability debate. Stewardship codes appear to perform best when three conditions are met:

- (a) the underlying corporate decision is already subject to a shareholder vote, so that stewardship aligns with an existing, binding decision point;
- (b) collective investor coordination is possible without running into "acting in concert" problems; and
- (c) the target company's ownership structure actually permits outside shareholder influence.

Where these conditions are absent, such as in controlling-shareholder companies or in

[16] Lindsey Stewart, *Proxy Voting on Sustainability: The Big Three Hold the Key*, Morningstar (2024), https://www.morningstar.com/sustainable-investing/proxy-voting-sustainability-big-three-hold-key (reporting that State Street's support for well-supported environmental and social resolutions fell from 46% in the 2022 and 2023 proxy years to 22% in 2024, compared with 12% for BlackRock and 0% for Vanguard); *BlackRock Supported Less Than 2% of Environmental and Social Proposals in 2025 Proxy Season*, ESG Dive (2025), https://www.esgdive.com/news/blackrock-support-environmental-social-shareholder-proposals-less-than-2-percent-2025-proxy-season/759918/.

[17] Tokyo Stock Exch., *Appointment of Independent Directors / Establishment of Nomination and Remuneration Committees by TSE-Listed Companies* (July 18, 2025), https://www.jpx.co.jp/english/equities/listing/ind-executive/b5b4pj000004ehtg-att/sjcobq000001u1py.pdf (reporting Prime Market data on the proportion of companies with at least one-third and with a majority of independent directors).

governance failures that never reach a formal vote, even a well-drafted stewardship code has little independent ability to change outcomes.

6.6 Three Illustrations

Exxon Mobil (2021) – A small activism fund, Engine No. 1, gained 3 directorships over the board's nominees by gaining the backing of several large institutions including some of the largest index managers.[18] This shows condition (a) in section 6.5 holds true as the stewardship led to meaningful change due to the presence of an enforceable shareholder vote. It also demonstrates how passive managers' influence is reliant on others. The campaigning was done by an activist fund and the outcome was decided by the index managers.

Toshiba (2020-21) – Toshiba had an independent investigation into their company and found that they had wrongly influenced the shareholders' voting at their 2020 AGM by trying to coerce an activist. The result was the removal of the chair at the 2021 AGM.[19] Despite the existence of the Stewardship Code and Corporate Governance Code in Japan for many years, there was still an issue. This shows that condition (c) is true and that the codes do not have much influence if the management can influence how votes are cast. The need for trustworthy and traceable voting is also highlighted here which ties in with the procedural aspect of the model.

Hermes UK Focus Fund – It was found that the Hermes UK Focus Fund, a specialised engagement fund, had most of its returns from private engagements. The fund made positive abnormal returns. This shows that stewardship can add value but that the benefits only come from a firm whose business model is engagement based. This relates back to the argument in part 5 that there are large differences in the economics of stewardship dependent on the investment strategy, and therefore it is unlikely that a one-size-fits-all approach will work.[20]

[18] Thomas Ball, James Miller & Shirley Westcott, *Was the Exxon Fight a Bellwether?*, Harv. L. Sch. F. on Corp. Governance (July 24, 2021), https://corpgov.law.harvard.edu/2021/07/24/was-the-exxon-fight-a-bellwether/ (reporting that BlackRock voted for three, and Vanguard and State Street each for two, of Engine No. 1's nominees).

[19] Toshiba Chairman Voted Out After Governance Scandal, CNBC (June 25, 2021), https://www.cnbc.com/2021/06/25/toshiba-chairman-voted-out-after-governance-scandal.html; Press Release, Effissimo Capital Mgmt. Pte. Ltd., Effissimo Continues to Demand Better Governance and Compliance at Toshiba (June 18, 2021), https://www.businesswirechina.com/hk/news/47159.html (describing the investigators' report issued June 10, 2021).

[20] Marco Becht, Julian Franks, Colin Mayer & Stefano Rossi, *Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes UK Focus Fund*, 22 Rev. Fin. Stud. 3093 (2009).

7. Recommendations for Reform

On the basis of the comparative and doctrinal analysis above, regulators and legislators considering the next generation of stewardship regulation should pursue five reform directions.

7.1 Separate the substantive and procedural layers of the stewardship obligation. Maintain a flexible, narrative "apply-and-explain" standard for the qualitative assessment of engagement effectiveness, in line with the UK's 2020 reforms. At the same time, mandate with binding legal force the objectively verifiable procedural elements: resolution-level voting disclosure, conflict-of-interest policies and engagement escalation frameworks, following India's model.

7.2 Introduce independent assurance of stewardship reporting. Stewardship reports that claim particular engagement outcomes should be subject to independent verification or assurance, just as financial statements are subject to external audit. This would limit the ability of signatories to claim credit for outcomes they did not materially influence.

7.3 Consolidate fragmented, sector-specific codes into a single cross-sectoral framework. India's division of stewardship regulation among IRDAI, PFRDA and SEBI illustrates the problem. A single framework would hold insurers, pension funds and mutual funds to a consistent and comparable standard rather than to disparate sectoral codes.

7.4 Calibrate expectations to investment strategy. The stewardship economics of a concentrated active manager and of a broad-based passive index fund are fundamentally different. Codes should therefore set differentiated, rather than uniform, disclosure and engagement expectations, as Japan has begun to do for asset managers, asset owners and service providers

8 Clarify the legal boundary of collective engagement. To address the free-rider and scale problems of individual stewardship without exposing cooperating investors to unintended liability, regulators should state clearly where lawful collective stewardship ends and prohibited "acting in concert" or anti-competitive coordination begins. The UK and Japanese regulators have begun this task, and others should follow.

8. Conclusion

In today's corporate governance, institutional investors occupy a structurally unique position. They are too large and too important to capital markets to be left unregulated, but too varied in strategy, scale and mandate to be subject to a single, universal rule. In every jurisdiction

examined in this article, stewardship codes have significantly raised the importance of voting disclosure, conflicts-of-interest management and long-term engagement as governance norms. They are an ambitious and, on balance, beneficial regulatory innovation.

However, more than fifteen years of experience since the UK's pioneering 2010 Code shows that the gap between disclosed stewardship policy and observed stewardship behaviour cannot be fully closed by voluntary, reputationally enforced principles alone. The way forward is not a choice between soft law and hard law. It is to divide stewardship obligations into their verifiable and non-verifiable components, and to match each with the enforcement mechanism best suited to make the underlying commitment credible: market reputation, independent assurance or binding regulatory sanction.

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