Appearance vs substance of Stewardship and ESG reporting: the challenges of translating 'commitment' into tangible outcomes.

By Dr. Anna Tilba[1]

Abstract

Purpose – This paper examines the stewardship practices of BlackRock, one of the world's biggest index managers, in order to highlight a tension and contradictions associated with demonstrating sustainability leadership and its actual substance.

Design/methodology/approach – To support its argument, this paper draws on the author's longstanding industry and academic experience, existing academic evidence and documentary analysis.

Findings – The paper reveals conflicting data, highlighting a tension between BlackRock's commitment to ESG in its public statements and translating this commitment into tangible outcomes through voting, ESG investments and stewardship reporting, which seem to be more assumed than demonstrated.

Research limitations/implications – This viewpoint is based on a review of existing evidence. It offers some critique on current stewardship reporting practices, which has implications for management and policy makers. It identifies areas for future research in the area of stewardship and ESG reporting.

Policy implications – The paper highlights the need for a more critical interrogation of investor stewardship and ESG reporting and a more joined up policy and regulatory approach to stewardship and sustainability reporting.

Social Implications: - Improving stewardship practices of asset managers will help enhance the social value created by the financial services sector.

Originality/value – In drawing on personal experience and existing literature, the originality lies in the combination of arguments brought together to highlight the challenges of making sense of the conflicting ESG reporting data to see how this may impact policies, regulation and future practices in the area of sustainability and ESG reporting.

Keywords Sustainable development, stewardship, reporting, accountability, regulation.

Paper type Viewpoint

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Introduction

In the context of continuous scepticism around the role that institutional investors, particularly large global index investors, play in improving environmental, social and governance (ESG) concerns, this viewpoint will examine and compare BlackRock's public commitment to ESG in its statements to highlight the challenges of translating this commitment into tangible outcomes in practice. In so doing, this paper demonstrates the difficulties of judging the genuine ESG reporting and/or discovering 'greenwashing'. The paper starts with a brief review of investor stewardship and engagement methods to highlight conflicting empirical evidence about the effectiveness of index investors' engagement. I then highlight a tension between investor commitment to ESG and achieving tangible outcomes in practice. After briefly discussing methodology, the paper uses BlackRock, one of world's largest index money managers, as an example to examine and compare stewardship practices and reporting. The paper finds contradictory evidence between BlackRock's public ESG and stewardship statements and its voting, stewardship investment and reporting practices. This raises questions about BlackRock's ability to translate effectively their stewardship commitment and aspirations into meaningful outcomes, which could also reflect similar challenges within the broader investment community. The discussion contributes to the emerging literature on large indexers and debates about the role of the big index fund managers in the economy by elaborating on the nature of 'aspirational talk' and narratives in stewardship reporting, as well as highlighting the danger of engagement without a result or continuous engagement narrative that can also be prone to bias - a situation which can be exacerbated when engagement results in a 'failure'. I also consider the role of the regulators in this discussion and offer some thoughts on ways forward in the concluding remarks.

Investor Stewardship and Engagement

A significant body of governance literature has explored the role of institutional investors in the governance of investee corporations through stewardship and engagement[2]. It should be noted here that these debates have mostly taken place in the context of the primacy of investment returns and calls for a more responsible institutional investment ownership. Gomez-Mejia (1997) characterised a responsible investor as long-term, active and interested in the non-

[2] See for example a recent review of this literature by McNulty and Nordberg (2016) and Tilba and Reisberg (2019).

financial issues of the investee company. These non-financial issues include ESG aspects, alongside financial factors.

Similarly, public and policy debates about investor engagement are increasingly being framed around the language of stewardship, which is evident from a number of regulatory 'soft-law' codes that have prescribed institutional investor practices. For example, the Myners Review (2001) and the HM Treasury Review of Myners' Principles (2008) have highlighted the significance of the institutional investor role in corporate governance. By 2006, the UK Combined Code[3] on Corporate Governance required of institutional investors that: they make considered use of their votes; enter into a dialogue with investee companies based on the mutual understanding of objectives; and give due weight to all relevant factors drawn to their attention when evaluating corporate governance arrangements in their investee companies. Over the years, the Code has been revised and expanded to take account of the increasing demands on the UK's corporate governance and the active role of institutional investors in it.

Similar requirements have been published by the ISC's Responsibilities of Institutional Shareholders and Agents: Statements of Principles (Institutional Shareholders' Committee, 2007), and the principles published by the International Corporate Governance Network. According to the Principles for Responsible Investment (PRI), investor stewardship can be defined as: *'the use of influence by institutional investors to maximise overall long-term value including the value of common economic, social and environmental assets, on which returns and clients' and beneficiaries' interests depend*.[4]' Stewardship also requires firms to integrate ESG factors into their investment and capital allocation decisions. Thus, responsible investment '*involves both, including each feeding back into the other, for example by using insights garnered from engagement to enhance investment decision making – and vice versa'*[5].

Most recently, the newly revised UK Stewardship Code 2020[6] is specifically shifting focus away from 'comply and explain' and simply having a stewardship policy to 'apply and

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[3] FRC, Combined Code (2006) https://www.frc.org.uk/getattachment/8238c251-5cfe-43b7-abc0-4318ccbdc0fd/Combined-Code-2006-(Oct-version).pdf
[4] PRI About stewardship | PRI Web Page | PRI (unpri.org)
[5] PRI https://www.unpri.org/an-introduction-to-responsible-investment/an-introduction-to-responsible-investment-stewardship/7228.article#:~:text=Stewardship%20is%20investors%20using%20their,maximise%20overall%20long%2Dterm%20value.
[6] FRC, UK Stewardship Code 2020 https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Final2.pdf

explain', where signatories actually have to demonstrate how their engagement activities result in meaningful and tangible engagement outcomes.

Engagement Methods

Stewardship and engagement assume a variety of activities and methods, from applying exclusion policies to particular companies based on their poor ESG ratings, to company monitoring, as well as actively having a dialogue with senior management, voting, putting forward shareholder resolutions at AGMs, and publicly opposing or supporting those either as individual investors or collaboratively. Gillian and Starks (2000) find that the most effective method of engagement can be voting, while Martin, et al. (2007) suggest that the most influential forms of engagement can be found through 'internal engagement', by which investors influence corporate governance through the appointment of non-executive board directors or through 'direct engagement', where investors are dominant block-holders with powers to fire and hire a company's senior management. Jackson (2008) and Tilba and McNulty (2013) consider that engagement is most effective when investors voice their concerns informally and exert influence behind closed doors, suggesting that such a style of engagement is often overlooked within academic research. In addition, Lewis and MacKenzie (2000) argue that investor engagement means more drastic measures like not buying certain shares at all.

When it comes to large index investors and the dramatic increase in passively invested assets globally, there is also an increasing expectation on these funds to play a more prominent role in the way these companies are governed and how they affect society and environment in general (Azar, et al., 2020). In contrast to active managers, for whom selling shares or exiting can represent an engagement strategy, index investors do not have the option of selling (or not buying) the stock. They must consequently rely on 'voice' (Hirschman, 1970) and take an active role in governance by exercising their voting rights, engaging with management and voicing their concerns. Index funds usually cannot "vote with their feet" because they hold the stock of the company as long as the firm is included in the index tracked by the fund. Accordingly, large indexers can potentially exert significant influence over corporate decision-making, especially if their ownership stakes in these firms are high.

However, the evidence on the extent of institutional investor engagement and interest in ESG is mixed. In the next section, I will introduce a short and select summary of a lively scholarly debate about contrasting behaviours amongst institutional investors vis-à-vis corporations, and

in the process raise some interesting questions about investor commitment and the challenges associated with demonstrating (and reporting on) such a commitment in outcomes.

Engagement Commitment vs Outcomes

Large institutional investors can influence firms to improve their ESG related issues. This raises the question of how effective they are in achieving these outcomes. There is empirical evidence suggesting that some institutional investors are becoming increasingly involved in the issues of corporate governance. For example, most recently Velte and Oberman (2020) have revealed the active role those institutional investors play in relation to compensation and sustainability. Tilba and Reisberg (2019) and Alda (2020) provide further evidence of an increasing number of pension funds that are concerned with ESG. Alda (2020) also concludes that socially responsible investment funds produce superior financial performance.

There is also an emerging conversation about the role of ‘big’ index funds in influencing investee companies on ESG, and particularly climate related issues. For example, Azar, et al, (2020) provide a review of this literature while exploring the influence of the world’s largest index funds, often referred to as the ‘Big Three’ (BlackRock, Vanguard and State Street) index investors on the world’s carbon emissions. The authors find that that the ‘Big Three’ focus their engagement efforts on large firms with high CO2 emissions in which these investors hold a significant stake. Similarly, Gormley, et al (2021) highlight that index investors’ ability to influence broad-based governance is changing and find that campaigns to increase gender diversity on corporate boards launched by the ‘Big Three’ institutional investors led firms to add at least 2.5 times as many female directors in 2019 as they had in 2016. Dimson, et al (2021) explore the effect of collaborative engagement by large investors, finding that investors are more likely to lead the collaborative dialogue when the investor’s stake in and exposure to the target firm are higher, and when the target is domestic.

On the other hand, there also exists an established assumption which stipulates that moves to increase ESG engagement by index funds remain motivated primarily by a desire to improve financial investment returns. This assumption casts doubts on the role big index funds can play in helping to address ESG issues. For example, while examining the ‘Big Three’ impact on carbon emissions around the world, Azar, et al (2020) stress that their study does not imply that the level of monitoring provided by the Big Three is (net) socially optimal. Similarly, Evans, et al (2021) also discover the presence of what they call ‘Phantom ETF Shares’ and observe a decrease in large index fund voting. Interestingly, Dimson, et al. (2021) observe that large

investors are increasingly focusing on their coordinated efforts to improve environmental issues through initiatives like the Climate Action 100+ campaign. This was backed by 518 global investors with $47 trillion in assets who were committed to cutting emissions from 161 companies that generate 80% of global industrial greenhouse gas emissions. At the same time, these authors also note that there is still a need for rigorous evidence on the effectiveness of this process and on how best to organize it.

Indeed, there is persistent evidence to suggest that generating investment returns is paramount. Azar, et al (2020) suggest that the main motivation for the 'Big Three' investor engagement is that these large investors believe that reducing CO2 emissions increases the value of their portfolios. Strampelli (2020) also highlight that if shareholder objectives are not aligned with those of their managers, it is unlikely that investment fund managers could actually be incentivized to pursue sustainability policies that are responsible for a negative impact on profits, especially over the short term. The authors cast doubts on whether institutional investors can perform a "public" function for the benefit of society at large and replace governmental or regulatory intervention.

These concerns are not new. Pointing to the present era of 'Financial Capitalism', Davis (2008) and Jackson (2008) argued that although institutional investors are in a position to influence corporate managers, their use of equity stakes is generally liquid and without commitment. Hendry, et al. (2006) highlighted that both institutional investors and executives view themselves as profit-maximizers, rather than owners who attempt to improve corporate governance. Holland (2006) also suggests that the interest of institutional investors in the implementation of governance codes of best practice is primarily motivated by the desire to influence share prices. In the US, Anabtawi (2006) finds that investors use their power to benefit their own private interests at the expense of the firm. In the UK, MacNeil and Li (2006) also reveal that investors would tolerate non-compliance with governance codes of best practice as long as this non-compliance does not affect the share price, indicating only profit-maximizing incentives. Tilba and McNulty (2013) and Tilba and Wilson (2017) discovered that investment fund manager reporting to their pension fund clients is mostly retrospective and that most pension funds did not actively seek to engage with their fund managers on ESG issues - it is simply assumed that stewardship and engagement happens at that level. How it happens and what outcomes this engagement brings, however, remains unclear. There seems to be a gap between the notion of stewardship of sustainability that many institutional investors

declare within their policies and what is happening in practice, which is consistent with some of the theorisation of the aspirational talk literature.

Aspirational ESG talk and action

The lack of consistency between organizational corporate social responsibility (CSR) or ESG talk and action has been regarded as a serious problem that needs to be eliminated; the tension between communication and action and the established notion that communication is performative has evolved into many different streams of conversation in the humanities and social sciences. Weick (1969) especially contributed to this field by his observation that while making sense of their surroundings, organisations enact their own narratives and environment. Weick used the term 'enactment' to represent the idea that certain phenomena such as organizations or certain behaviours and human actions are created or enacted by being discussed. Similarly, Mills (1940) provided a seminal theory of vocabularies of motive, suggesting that when actors are articulating their motives, they are not merely describing their experienced social action, but also influencing others and themselves.

More recently, Cho, et al (2010) examined a cross-sectional sample of corporate environmental disclosures contained in the US 10-K annual report to find that worse environmental performers exhibit significantly more ''optimism" than their better-performing counterparts. This indicates a self-serving bias present in the language and verbal tone used in corporations' environmental disclosures. The authors highlight a need to consider the language and verbal tone used in corporate environmental disclosures, in addition to their quantity and thematic content, when investigating the relationship between corporate disclosure and performance. Similarly, Haack, et al (2012) found that the antagonistic success and failure narratives dialectically unfold over time and are replaced by the commitment narrative. In reading ESG reporting statements, one consequently has to be mindful of the obfuscation of bad news, emphasis on good news and organisations using more optimism and positive key words and other rhetorical devices (Cho, et al 2010).

In the context of CSR reporting, Christensen, et al (2013) were more positive in arguing that even superficial CSR 'talk' can result in social change even when organizations do not fully live up to their aspirations. Whist exploring vocabularies of motive of UK pension fund trustees, Tilba and Wilson (2017) found that a few UK pension funds had a more optimistic and positive narrative connected to the long-term were more engaged vis-à-vis their investee companies on ESG issues. At the same time, these authors also found that a majority of pension

funds used negative narratives of pension deficits, which resulted in short-term investment profit generation above all else.

Using BlackRock as an example, this viewpoint will consider these issues as a means of highlighting the tensions between corporate ESG and stewardship reporting and action. Drawing on abundant publicly available information sources, I highlight the challenges of making sense of conflicting data and reveal a tension between the appearance of sustainability leadership and its actual substance. In so doing, I draw attention to the need for a more critical interrogation of investor stewardship and ESG reporting.

Methodology

The views expressed in this paper are based on over a decade of academic research into institutional investors' practices in relation to sustainability and stewardship, as well as my advisory roles at the UK Law Commission, UK Financial Conduct Authority, Best Practice Principles (BPP) for Shareholder Voting Review Group, Competition and Markets Authority, the UK Pensions Regulator and the UK Financial Reporting Council. The views expressed here are my own and are supported by personal longstanding industry and academic experience of witnessing institutional investors' tensions between stewardship and sustainability reporting statements and investor actions. The main aim is to demonstrate the challenges of operationalising sustainability and question the role of index investors in the transition to a more sustainable economy.

Written documents and reporting statements represent an important source of information about investor stewardship activities. This viewpoint draws on a non-systematic selection of secondary data from academic papers and BlackRock public communications. This documentary analysis was complemented with news articles from credible media outlets, archival information, circulars, bulletins, press releases and publicly available information. Documentary analysis also included policy documents such as the numerous codes for best institutional investor practice published by government departments and other industry organizations. The analysis of these documents set the context against which to analyse BlackRock's stewardship activities.

It is important to emphasize that written documents, like the spoken word, are also products of social construction. The documents analysed here, including the codes of best practice, are consequently seen as written for a certain audience with certain intended outcomes in order 'to get a particular point of view across' (Atkinson and Coffey, 1997, p. 61). Therefore, the purpose

of this viewpoint is to reflect on my own observations and experiences and provide documentation of what I have collected in my own quest for making sense of these sustainability tensions.

Documentary analysis focused on BlackRock reporting and public statements in the past five years and cross-examining it with other documentary evidence. For example, statements made by Larry Fink, CEO of BlackRock, about voting and stewardship resourcing were compared with other sources such as ShareAction reports on Investor Voting trends and similar reports by other non-profit, non-governmental organisations, as well as existing peer-reviewed academic evidence on BlackRock engagement and stewardship resourcing. The five-year mark was selected to capture any recent changes in expectations of index investors' role in ESG and any changes in their behaviour.

The BlackRock Example

BlackRock is one of the 'Big Three' index money managers and it is expected of them to demonstrate leadership in ESG, sustainability and climate protection. In other words, there is an expectation that BlackRock not only participates in AGMs and votes its shares, but also there is increasing scrutiny on *how* they vote and whether it is consistent with what they *'say'* about it. BlackRock has more than $6.5 trillion in assets under management, mechanically tracking the performance of an index and holding an increasingly large proportion of equity of publicly trading companies globally, giving the firm enormous power over the global financial system. In the UK, BlackRock has been investing money on behalf of clients for over five decades, employing over 3,300 employees, managing the assets of over 10 million pension schemes and investing in excess of £192 billion in UK public companies (BlackRock, 2021c). In recent years there has been an increasing amount of policy pressure and public demand for these large global investors to exert more pressure on their portfolio companies to act on ESG issues. Bebchuk and Hurst recently wrote that:

> *'The stewardship promise of index funds arises from their large stakes and their long-term commitment to the companies in which they invest. Their large stakes provide these funds with significant potential influence and imply that by improving the value of their portfolio companies they can help bring about significant gains for their portfolios. Furthermore, because index funds have no "exit" from their positions in portfolio companies while those companies remain in the index, they have a long-term perspective and are not tempted by short-term gains at the expense of long-term value' (Bebchuk and Hurst, 2019, p. 2034).*

However, whether the efforts of these investors to influence their investee companies, particularly on environmental and social issues, is meaningful and/or effective remains an open empirical question. There is certainly an increase in highly publicized vocal commitment by BlackRock to be more proactive in this area. For example, in 2017 BlackRock published a significantly higher number of press releases relating to environmental issues. In March 2017, Larry Fink, Chairman and CEO of BlackRock, made strong public statements on Blackrock's commitment to ESG issues[7]. Later, in May 2017 BlackRock voted in support of the ExxonMobil climate-related shareholder proposal. Azar, et al's (2020) investigation of The Big Three engagement on carbon emissions suggests that the year 2017 was a turning point in terms of Blackrock's efforts to influence investee firms to improve their environmental practices.

In subsequent letters to CEOs, Larry Fink has stated that it is BlackRock's fiduciary responsibility to help their major pension fund clients to invest in the long term where tackling climate change is becoming a key factor in determining companies' long-term prospects. Commitment to net zero carbon emissions, sustainability and deeper connections to stakeholders signals BlackRock's willingness to devote the necessary resources to stewardship and an organisational belief in the benefits that their stewardship investments produce. This commitment was specifically highlighted by Larry Fink when he stated that BlackRock:

> "*…intend[s] to double the size of [its] investment stewardship team over the next three years. The growth of [BlackRock's] team will help foster even more effective engagement…with public companies to promote corporate governance practices that are consistent with encouraging long-term value creation for shareholders in the company"* (Fink, 2018).

In his 2020 letter, Larry Fink also stated that:

> *"[W]e will be increasingly disposed to vote against management and board directors when companies are not making sufficient progress on sustainability-related disclosures and the business practices and plans underlying them."*

He added that:

> *"…climate change is almost invariably the top issue that clients around the world raise with BlackRock. (…) In the near future – and sooner than most anticipate – there will be a significant reallocation of capital"* [8]

In outlining BlackRock's 2021 Stewardship Expectations, the firm re-affirmed its commitment to sustainability by equating sustainability risk and climate risk in particular to investment risk.

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[7] Ross Kerber (2017) https://www.reuters.com/article/us-blackrock-climate%20exclusive/exclusive-blackrock-vows-new-pressure-on-climate-board-diversity-idUSKBN16K0CR

[8] Larry Fink (2020) Letter https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

BlackRock's updated Stewardship Expectation policies are said to reflect efforts to strengthen continuously BlackRock's stewardship practices (BlackRock, 2021a). Similarly, in a letter to their clients, BlackRock claimed that they are committed to stewardship by:

> *"…using investment stewardship to ensure the companies our clients invest in are mitigating climate risk and considering the opportunities presented by the net zero transition [and] increasing the role of votes on shareholder proposals in our stewardship efforts around sustainability"* (BlackRock, 2021b).

The commitment of BlackRock to sustainability and ESG is also being publicized in other sources. For example, at a conference hosted by the Institute of International Finance, Fink stated: '*Companies that do not adopt sustainable business strategies can expect less investment as shareholders grow more focused on topics like climate change'* (Kerber, 2021). BlackRock has been a Signatory of the Responsible Investment Principles (PRI) since 2008 and achieved an A or A+ score across all six categories of compliance with the principles (BlackRock, 2020a). In their response to the recent International Financial Reporting Standards Foundation (IFRS) Consultation Paper on Sustainability Reporting, BlackRock strongly supported a global set of internationally recognized sustainability reporting standards. The firm called on their investee companies to enhance their sustainability reporting, highlighting that: *"Important progress improving disclosure has already been made – and many companies already do an exemplary job of integrating and reporting on sustainability – but we need to achieve more widespread and standardized adoption"* (BlackRock, 2020b). Most recently, BlackRock was successful in re-applying and securing Signatory status to the UK Stewardship Code 2020[9].

However, there is a tension between BlackRock's commitment to ESG in policy and practice. It is not well understood what outcomes are achieved through index funds' stewardship, company monitoring, voting and engagement with portfolio companies. Answers to these questions have a significant impact on the governance and performance of both public companies and the economy as a whole (Bebchuck and Hurst, 2019). Understanding the stewardship practices of these organisations continues to be an important dimension of governance research and practice. With its growing economic and political influence (Ordonῆez, 2020), where BlackRock is characterised as maintaining a 'revolving door' with the US Government, appointing former government officials to top jobs at the company, and preparing its own executives to take jobs in government, including at the Federal Reserve and

[9] FRC UK Stewardship Code 2020 Signatories https://www.frc.org.uk/investors/uk-stewardship-code/uk-stewardship-code-signatories

in the new Biden administration (Rock, 2021), understanding how BlackRock delivers on its own promises is crucial. The next section reflects on the tensions between appearance and substance in BlackRock's sustainability efforts.

Appearance vs substance?

Notwithstanding BlackRock's public commitment to sustainability, there is growing concern from environmental organisations who have criticized BlackRock for investing its customers' money worldwide in carbon-intensive businesses and holding stakes in large oil companies such as Exxon Mobil, Chevron and BP. According to the Polanz and Taßler (2020) report, environmental organizations examined twelve of the most climate-damaging, large-scale projects worldwide (for example, oil production projects in the deep sea off Guyana, gas fields in Mozambique, and new coal-fired power plants in Bangladesh) where BlackRock was the largest investor in those projects overall. Despite being an index fund without a possibility to exclude companies, BlackRock has been heavily criticized for being one of the three biggest buyers of so-called "brown bonds", which enable large oil companies, for example, to continue to finance environmentally harmful projects. At the same time, the latest survey results from a German magazine "Finanztest" from July 2020 suggests that BlackRock's 'sustainable' funds actually come off worse in four out of five cases where sustainability is concerned (Polanz and Taßler, 2020).

BlackRock Voting

Through their index investments, BlackRock also holds extensive investments in the coal, automotive and cement industries. As the lack of an exit possibility associated with index investments increases the importance of stewardship engagement, it is consequently important to know that investors not only vote, but also *what they vote for* and what they *say* about it.

BlackRock CEO Fink has stated that: "BlackRock cannot express its disapproval by selling the company's securities as long as that company remains in the relevant index. As a result, our responsibility to engage and vote is more important than ever" (Fink, 2018). Given this commitment, it is interesting to find some contradictory data on BlackRock's voting practices.

In their UK Stewardship Code compliance statement, BlackRock report that they 'intend to vote at all shareholder meetings of companies in which our clients are invested.' (BlackRock, 2020c). However, a recent report on shareholder voting by ShareAction (2020) reveals a

different picture. When it comes to shareholder voting, European asset managers[10] continue to outperform US asset managers, where EU based managers like Impax Asset Management, Aviva Investors, PGGM Investments, Man Group, Legal and General Investment Management, and NN Investment Partners have voted on 95% of resolutions or more. The only US-based asset managers that improved their voting performance were Northern Trust Asset Management, JPMorgan Investment Management and Wellington Management Company.

In addition, ShareAction's Report considered *how* sixty of the world's largest asset managers voted on 102 shareholder resolutions on climate change, climate-related lobbying, and social issues during the period September 2019 to August 2020, and how they justified their voting choices. Worryingly, the Report found that one in six asset managers did not use their voting rights on over 10 per cent of the resolutions on which they could have voted. Furthermore, seventeen additional resolutions would have passed if one or more of the Big Three asset managers (Blackrock, Vanguard Group, and State Street Global Advisors) had changed their vote. In all of these cases, BlackRock voted against the resolutions. The analysis also found that five Climate Action 100+ members, including BlackRock, voted for 50 per cent or less of climate resolutions. (ShareAction, 2020). Table 1 demonstrates the actual breakdown of BlackRock's voting in comparison with the top 3 performers out of 60.

[INCERT TABLE 1 HERE]

These findings are consistent with earlier evidence presented by Bebchuk and Hurst (2019), who found that Big Three index managers (including BlackRock) pay little attention to whether their investee company suffers from financial or business underperformance that might call for "fixing the management".

When voting on climate resolutions at invested banks, BlackRock voted against such resolutions in 7 out of 8 cases. BlackRock's support for pay-gap reporting resolutions was less than 10% (ShareAction, 2020). In many of those cases, BlackRock's support for the resolutions would have given them enough votes to pass (Rock, 2021). The resolutions that would have passed with BlackRock's vote included proposals that would have held JPMorgan Chase's board accountable for its role as the world's largest fossil fuel financier and bring much-needed transparency to the lobbying efforts of Duke Energy, one of the largest and highest-emitting electric utilities in the U.S. (Majority Action, 2020).

[10] Not all of these managers are index fund managers.

According to another report by Majority Action (2020), BlackRock and Vanguard voted for nearly all (99%) U.S. company-proposed directors across the energy, utility, banking, and automotive sectors reviewed in that report. Furthermore, BlackRock is now seeking to block a shareholder resolution on its corporate purpose commitments, just days after Larry Fink emphasized the issue as being "pivotal to creating durable value" (Verney, 2021). Despite the above evidence, Fink issued a new CEO letter in January 2021 once again casting BlackRock as an environmental leader.

BlackRock Stewardship Resourcing

In 2018, BlackRock announced its plan "to double the size of [its] investment stewardship team over the next three years." (Fink, 2018) Given BlackRock's commitment to invest more resources in its own stewardship activities, and also considering that each of the Big Three asset managers (BlackRock, Vanguard and SSGA) have positions of $1 billion or more in numerous companies, with BlackRock holding more than 400 such positions, it would be reasonable to assume that substantial investments in stewardship are therefore likely to be value enhancing in many cases (Bebchuk and Hurst, 2019). In practice, however, this seems not to be the case.

In their assessment of the Big Three stewardship practices, Bebchuk and Hurst (2019) again raise significant concerns over substantial underinvestment in stewardship. For example, when it comes to personnel, BlackRock only had 45 stewardship personnel for an estimated 11,246 portfolio companies worldwide. Table 2 demonstrates the Big Three's total investment in stewardship, which highlights how all three stewardship budgets are less than one-fifth of 1%—only 0.2%—of the estimated fees that each of the Big Three charge for managing equity assets.

[INSERT TABLE 2 HERE]

Bebchuk and Hurst (2019) highlight that:

> *'The Big Three spent very limited resources on stewardship—either in personnel time or in dollar cost—per portfolio company, including for positions of significant monetary value. Even under the most conservative assumptions, in order to oversee each of their billion-dollar positions, BlackRock spent less than 4 person-days per year and less than $5,000 in stewardship costs per year' (p. 2079).*

The authors conclude that although BlackRock emphasizes the importance of stewardship, their stewardship budgets are economically insignificant relative to the fees that they charge.

The authors also note that stewardship budgets of each of the Big Three could easily be increased multiple times without creating any material funding problem.

Reporting Activities vs Achieving Meaningful Outcomes

Policymakers, regulators and other market participants increasingly demand that investors report not only that they have stewardship and ESG policies on paper, but also demonstrate tangible outcomes on what these policies achieve in practice. However, actually achieving and claiming engagement success is not always straightforward. While BlackRock appears clearly to understand what good stewardship looks like on paper, it is harder to determine whether they actually practice it and what specific outcomes are being achieved through often voluminous engagement activities that are being recorded and reported.

For example, by examining BlackRock's latest Investment Stewardship Annual Report (2020)[11], which was successfully submitted to the UK Financial Reporting Council as part of the UK Stewardship Code Signatory reporting, it becomes less clear what specific ESG outcomes are being achieved. For example, in Latin America BlackRock states that they participated in 75 industry events, client meetings and roundtables with local regulators and investors in order to '*discuss the importance of adopting sound corporate governance and business practices to create long-term, sustainable growth*' (p.42). However, no further explanation on what has been achieved is given in the report.

Similarly, in the case study on 'Engaging with Asian shipping companies on seafarers' labour conditions', BlackRock identified a need for '*urgent action on the challenging labour conditions facing seafarers trapped at sea because of country restrictions during COVID-19… to address the situation of thousands of seafarers working "well beyond usual periods of service at sea," with some for as many as 17 months or longer.*' (p.101). However, it is unclear what tangible improvements in seafarers' labour conditions were achieved through this engagement beyond companies just acknowledging that this problem exists. The Outcomes section of this case study concluded simply by suggesting that: '*BIS will continue to engage with these companies to monitor their progress in bringing greater attention to and implementing additional measures to address this issue*' (p.101). Has this engagement resolved the 'urgent action' to improve seafarers' conditions by reducing the time spent at sea? The answer seems to be 'no'. No doubt, we can accept that action and outcomes on some ESG

[11] BlackRock Investment Stewardship Annual Report (2020) https://www.frc.org.uk/getattachment/846fa0f5-3a5c-4580-b3be-c7ad3e9f938e/BIS-2020-Calendar-Year-Annual-Report-FINAL_STAMPED.pdf

issues take time and the longitudinal nature of such engagement assumes that there may not be a concrete result at a certain point in time. At the same time, we also need to be mindful of the danger of engagement activities reporting becoming endless and perhaps even pointless.

Other Examples

In addition, certain voting behaviours can be a ‘red flag’ for stewardship concerns. For example, the lack of BlackRock support for a shareholder resolution to report on pay gaps is also reflected in its own reporting where no such indicators are given. Nor is BlackRock a member of Accredited Living Wage Employers, a UK based organisation that recognises employers who believe their staff deserve a wage which meets everyday needs. A broad range of employers are accredited with the Foundation, including 20% of the FTSE 100, with such firms as Nationwide, Google, Aviva, 3i or Hermes amongst the membership (Living Wage Foundation, 2021).

Discussion

This paper adds to the emerging literature on the role of large index funds (such as The Big Three) in the economy (for example, Bebchuk and Hirst, 2019b; Coates, 2019; Fisch et al., 2020). In particular, this paper adds to recent academic work which casts doubt on the effectiveness of the Big Three to produce meaningful ESG outcomes (Azar, Schmalz and Tecu, 2018; Anton, Ederer, Gine, and Schmalz, 2018; Bebchuk and Hirst, 2019). In an industry where consumer rights are abused regularly and where the levels of public trust in its services consistently have been at low levels (Edelman Trust Barometer, 2021), highlighting the challenges of achieving meaningful outcomes and a tension between stewardship appearance and substance, as well as verifying claims associated with sustainability, is an urgent task. Despite public and policy emphasis on investor stewardship, concerns over substance still remain.

It is also worth reminding readers that when it comes to ESG, stewardship and accountability, there is no lack of guidance in the form of governance codes and other best practice initiatives (namely, what good governance looks like). The problem is consequently not one of a lack of practical frameworks and best practice policy guidance. Nor is there a lack of academic theorisation and optimism about ‘self-fulfilling’ aspirational talk when it comes to sustainability reporting in the aspirational talk literature (Cho, et al., 2010; Christensen, et al, 2013; Haack, et al, 2012). For example, Haack, et al (2012) argued that narratives that co-

evolve with the dispersal and embedding of CSR standards can shed light on whether a formally adopted practice becomes filled with meaning beyond just 'written words' and become gradually accepted, understood and enacted as the 'natural way of doing things' within organisations. This is something I have also observed in the context of institutional investors and their engagement (Tilba and Wilson, 2017). Furthermore, trustees of more engaged pension funds interpreted their fiduciary duty to include not only narrow financial interests but also broader ESG issues (Tilba and Reisberg, 2019).

Indeed, BlackRock's stewardship seems to be improving as there is clearly a positive change in the corporate narrative from 'the top', as well as improved reporting, which aims to provide examples of engagement activities and successes via case studies and other statistics (BlackRock, 2020). Indeed, BlackRock is committed to providing more proxy voting options to clients (William-Smith, 2021). Blackrock is also launching a centre for stakeholder capitalism, which brings together "leading CEOs, investors, policy experts, and academics to share their experience and deliver their insights" (Turner, 2022). All this suggests that BlackRock's stewardship is becoming more substance-led.

At the same time, as this paper reflects, although improvements are being made in policy and practice, investor commitment to ESG might not easily translate into effective initiatives that result in tangible positive change. Although according to the most recent ShareAction (2021) report BlackRock's support for shareholder resolutions increased from 12% in the previous year to 40% in 2021, it still voted against a significant number of resolutions, including 100% of those on executive pay disparity, employee representation at board level, public health and tobacco, and weapons companies (Turner, 2022). ShareAction's (2021) report on voting concludes that the world's largest asset managers (including BlackRock) continue to block efforts to make progress on environmental and social issues, highlighting that voting performance of the industry overall has remained stagnant. BlackRock's voting is also said to be more conservative than proxy voting services' recommendations.

ESG engagement is often said to be a 'journey', but it should not be an unfinished one. Milne, Kearins and Walton (2006) argued that viewing sustainability as a 'journey' invokes a powerful use of language that stakeholders can engage with, but at the same time, paradoxically, this use of language seems to further reinforce 'business-as-usual' when it comes to change. It is important to consider that the term 'narrative' typically assumes 'beginning-middle-end' (Carr 1986a) or 'beginning-middle-result'. This 'beginning-middle-result' structure allows us to

situate ourselves in 'the midst' of events and debates in a way that connects back to the past and forward to the future. It provides a way of thinking beyond the day-to-day operations of work and allows us to understand duration and judge progress made in relation to specific objectives and outcomes.

Transporting these ideas in the context of investor stewardship and engagement, and particularly their reporting narratives, the danger here is that with some engagement 'journeys' there seems to be no actual 'end-result' and some of the narrative on this engagement could well be prone to bias (Cho, et.al. 2010). This situation can be exacerbated if the result of engagement is a failure, which very few organisations like to discuss publicly.

It is clear that in giving an organisation a sense of time, narrative reporting on stewardship and engagement can give us a sense of achievement or at least an endpoint, which we can connect back to some origin and thereby somehow triangulate our current position in the middle to track engagement progress and outcomes. It consequently becomes important for stewardship ESG reporting not only to have a beginning and the middle but also an end result, which is not superficial. Furthermore, more attention and scenario planning should be given to situations where engagement results in 'failure' or inaction. Moreover, as big institutional investors have an important role in the economy, their ESG reporting could well be "greenwashing", rather than indicating actual improvement, whilst collecting the data on 'failed' engagements or missed opportunities is almost impossible.

Policy Implications

It is also important to consider where accountability lies and who actually enforces compliance. The answer to this question is not straightforward. For example, the UK regulatory architecture itself is complex and multi-layered. According to Sikka, et al (2019), the UK has 41 regulators for the financial sector alone, with at least 14 dealing with accounting, auditing, insolvency and some aspects of corporate governance. Such a framework has resulted in the replication of policies and guidance.

When it comes to stewardship, the important steps towards a joined-up approach have already begun when in February 2020 the UK Financial Conduct Authority (FCA), the Financial Reporting Council (FRC), the Department for Work and Pensions (DWP) and The Pensions Regulator (TPR) held a joint industry workshop on investor stewardship (Tilba, 2020). This

workshop followed on from a year-long investment industry-wide consultation on how to build a better regulatory framework for effective stewardship (FRC and FCA, 2019). Significantly, the newly revised Stewardship Code (2020) also now places greater emphasis on demonstrating engagement and what outcomes are actually achieved through voting and other methods. Given these developments, there is a need to capitalise not only on the recent stewardship policy reforms but also introduce greater harmonisation and co-operation into the regulating landscape itself. For example, for the updated 2020 Stewardship Code to have more weight[12] in terms of its meaningful applicability in practice, it needs to be recognised by the FCA (Tilba and Reisberg, 2019).

In addition, there is a need for a deeper and more nuanced understanding of the current tensions in stewardship practices of asset managers and asset owners. Judging stewardship is difficult, particularly trying to work out what "effective" stewardship looks like.

When it comes to the role of benchmarks and indexers, it is a multi-stakeholder problem, which does not have a single solution. In other words, there is a complex interdependence with trade-offs between multiple stakeholders such as the government, business and civil society. It should also be noted that the influence of each of these groups is not equal; society holds relatively little power in comparison to business and governments. Large index funds do not hold the role of the regulators yet seem to be treated as such when it comes to the sustainability/ESG agenda. There are agency issues here that need to be kept in mind.

Regulators also need to look closely at the costs of switching and the role of investment consultants who have been slow to accept the value of stewardship and ESG. The majority of their staff also generally have no experience and/or relevant qualifications in this area, following binary tick-box rating checklists.

Conclusion

Considering the existence of the mixed evidence of investor stewardship and engagement with increasing concerns over "greenwashing" and 'box-ticking' when it comes to sustainability, this paper has examined contrasting evidence on the stewardship practices of BlackRock to highlight the challenges that institutional investors face in pursuing sustainability when the

[12] FCA can give more 'weighting' to industry codes by recognising those codes https://www.fca.org.uk/about/recognised-industry-codes

parameters of success are so strongly linked to capital markets. In particular, it highlighted that the appearance of sustainability leadership does not always lead to meaningful outcomes. For stewardship to have a meaningful and positive impact on society and the economy, it is crucial to shed more light on the governance and organisation of stewardship activities, including oversight, resourcing, monitoring and reporting. More specifically, it would be important to understand what engagement success looks like in outcomes, how do investors record engagement activities, what they consider to be a successful outcome in reporting, and whether there is a difference between the two. We would also need to understand better the role of external stewardship service providers such as proxy voting services in ESG reporting. Crucially, evidence-based commitment through 'Apply and Explain' principles ought to translate meaningfully into practice beyond simply having an engagement 'journey' without end.

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