Principles for Responsible Investment

UNLOCKING THE POTENTIAL OF INVESTOR STEWARDSHIP IN CHINA:

TOWARDS A MORE SUSTAINABLE ECONOMY

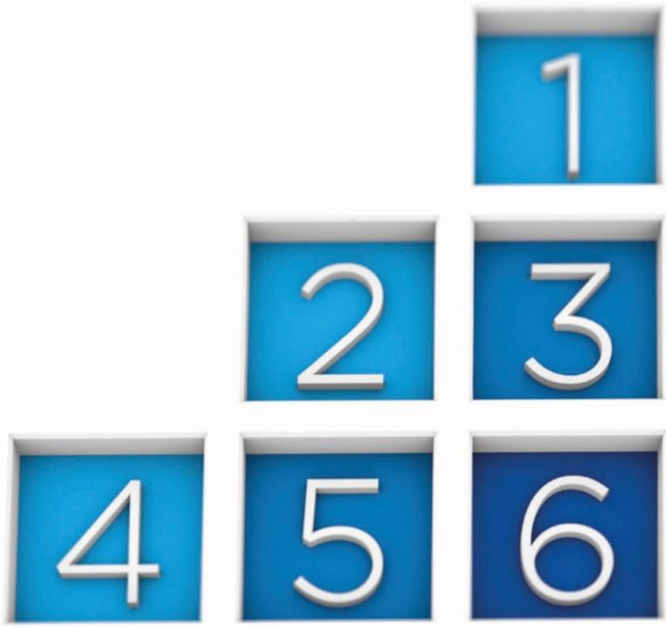
An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.



PRI'S MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

CONTENTS

EXECUTIVE SUMMARY

Institutional investors can be important actors in ensuring effective corporate governance, the development of the real economy and the achievement of sustainability and climate goals. In their roles as owners of and lenders to companies in the real economy, they can use their rights and influence to drive positive change among investees in a process known as stewardship.

The case for stewardship, or active ownership, is set out in Part I. It is 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 financial returns and clients' and beneficiaries' interests depend. It is derived from investors' fiduciary duties, and is reflected in the PRI's Principle 2, which requires signatories to be "active owners and incorporate ESG issues into [their] ownership policies and practices".

Through engagement with company management and voting at company meetings, as well as employing other tools, investors can use stewardship to improve risk and return, fulfil their fiduciary responsibilities, meet regulatory obligations and deliver real-world ESG outcomes. Although the practice started within listed equity, it is applied across a range of asset classes and in a growing number of jurisdictions.

To encourage institutional investors to engage with investees in a constructive and responsible manner, some 23 countries and regions have adopted stewardship codes to further guide investor stewardship activities. These share some common principles but are also tailored to the specific contents of each jurisdiction.

STEWARDSHIP IN CHINA

Despite the rapidly growing size and sophistication of financial markets and institutional investors in China, limited regulatory attention has been paid thus far specifically to stewardship practices. However, within China's existing regulatory framework, regulators are increasingly recognising the need for investors to manage ESG risks and impacts and support solutions to broader economic, social and environmental issues, including systemic ones.

Specifically, the Guiding Opinions of the People's Bank of China (PBoC), the China Banking and Insurance Regulatory Commission (CBIRC), the China Securities Regulatory Commission (CSRC), and the State Administration of Foreign Exchange (SAFE) on Regulating the Asset Management Business of Financial Institutions – also known as the New AM Regulation – have laid foundations which could be used to clarify institutional investors' stewardship responsibilities.

Meanwhile, market participants in China are already pursuing a wide variety of stewardship practices, including in relation to ESG factors and sustainability outcomes. Part II of this report draws on case studies of nine signatories active in China. It examines why they practice stewardship, how they do so, the challenges they face and some potential solutions.

Part III maps existing Chinese regulations against core stewardship principles common to other jurisdictions and identifies gaps and key areas for future policy reform.

RECOMMENDATIONS

Finally, Part IV offers five recommendations for Chinese policy makers for developing and improving the regulatory framework for effective stewardship. To do so, financial policy makers in China should:

- Recommendation 1: Develop a stewardship code
- Recommendation 2: Improve the sustainable investment policy framework and stewardship infrastructure
- Recommendation 3: Adopt a phased approach towards effective implementation of the stewardship code, avoiding mechanical box-ticking compliance
- Recommendation 4: Ensure a joined-up approach from financial regulators to create a common language for stewardship
- Recommendation 5: Encourage investors to leverage collaborative engagement to maximise the influence of minority investors

PART I: AN OVERVIEW OF THE DEVELOPMENT OF STEWARDSHIP AND STEWARDSHIP CODES

1. STEWARDSHIP AND ITS DEVELOPMENT

Institutional investors, including asset owners and asset managers, can be influential players when it comes to supporting effective corporate governance, development of the real economy and the achievement of sustainability and carbon neutrality goals. They are not only capital suppliers but also stewards of entrusted assets, obliged to manage investments in the best interests of their clients and beneficiaries. As investors, they have a wide spectrum of means and rights to engage with and monitor the management of investees and drive changes in corporate performance, to mitigate risks and create value, and even to shape sustainability outcomes and impacts.

Given the interdependence between financial and economic activity and the environmental and social systems on which it relies, there has been an increasing focus on the financial community as a source of solutions to systemic environmental, social and governance (ESG) challenges. Investors have been actively responding to these expectations; over 4,500 investors and service providers with approximately US$120trn in assets under management have joined the PRI and committed to the six principles of responsible investment.

The first two principles set out the two major responsible investment approaches, ESG incorporation and stewardship (also known as active ownership). Compared with ESG incorporation, the value of stewardship has historically been underappreciated. The last decade, however, has seen responsible investors, individually and collectively, exercising stewardship increasingly actively to drive positive change among investees.[1] To support these developments, around 23 countries and regions have adopted stewardship codes to further guide investor stewardship activities.

A DEFINITION OF STEWARDSHIP

Stewardship, or active ownership, is 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 financial returns and clients' and beneficiaries' interests depend.[2] The expectation of investors exercising stewardship is derived from investors' fiduciary duties, particularly the duty of loyalty and prudence, to protect and enhance long-term value for their beneficiaries or clients.[3] It is also reflected in the PRI's Principle 2, which requires signatories to be "active owners and incorporate ESG issues into [their] ownership policies and practices".

[1] See, for example, Climate Action 100+, which provides an example of how investors are exercising stewardship to help investee companies mitigate and manage climate risks and impacts.
[2] PRI, *An introduction to Responsible Investment: Stewardship*
[3] PRI, *Fiduciary Duty in the 21st Century Final Report*

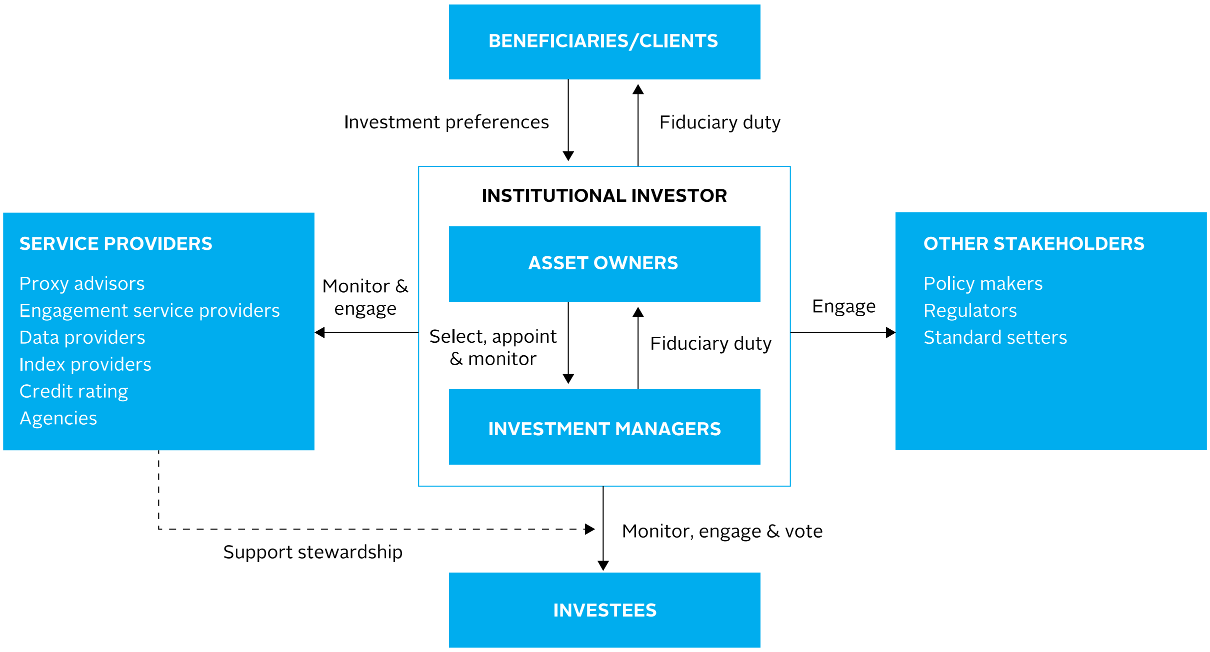
TOOLS

Investors can exert influence on current or potential investees/issuers through a variety of tools and rights. This includes engagement and voting – the two most widely used tools – as well as resolutions or proposals at shareholder meetings, shaping investee boards, supplier monitoring/negotiation, and litigation. Investors can also seek to improve broader market conditions and resilience to systemic risks through contributing to research and public discourse and by engaging with policy makers.

Table 1: Stewardship tools

The use of investor influence over current or potential investees	The use of investor influence with other non-issuer stakeholders
Engagement, formal and informal communication with investees or potential investees to improve ESG practices, sustainability outcomes or public disclosure	Engagement with regulators, standard setters and other stakeholders
Voting at shareholder meetings	Contributions to public goods[4]
Filing of shareholder resolutions	Participating in public discourse
Direct roles on investee boards and board committees	Negotiation and monitoring of service providers
Litigation	

Chart 1: Stewardship responsibilities along the investment chain



[4] For example, contributing to public research on addressing systemic risks such as climate change.

DRIVERS OF STEWARDSHIP

As a solution to the agency problem of corporate governance, short-termism in investment practices, and the imposition of corporate externalities on the environment and society, stewardship has been considered vital to the healthy functioning of markets. Investors have been primarily motivated to practice stewardship for the following reasons:

Improving risk-return

The potential of effective stewardship to improve the long-term financial performance of investee companies has been widely evidenced by empirical research.[5]

Fiduciary duties

Effective stewardship is a core component of investors' fiduciary duties to their clients and ultimate beneficiaries. This requirement has increasingly been interpreted to include the need to factor material ESG issues into investment analysis and decision-making and to exercise stewardship to mitigate risks and create value.[6]

Regulation

Policy makers are increasingly encouraging institutional investors to take an active role in overseeing and influencing investee companies, including through strengthened regulatory frameworks and stewardship codes.

Universal owners

Investors with well-diversified, multi-asset global portfolios, known as universal owners, are increasingly concerned with systemic risks and have been pursuing stewardship to support broader sustainability outcomes and well-functioning financial markets.[7]

Focus on real-world outcomes

Stewardship enables investors to shape investment impacts and help to drive changes that lead to improved real-world outcomes for society, the environment and the economy.[8]

---

[5] Dimson, E., Karakas, O. and Li, X. (2015). "Active Ownership". *The Review of Financial Studies*, 28 (12), pp. 3,225-3,268. Jean-Pascal Gond, Niamh O'Sullivan, Rieneke Slager, Mikael Homanen, Michael Viehs, Szilvia Mosony (2018) *How ESG Engagement Creates Value for Investors and Companies*. Tamas Barko, Martijn Cremers, Luc Renneboog, (2017) Shareholder engagement on Environmental, Social and Governance Performance.

[6] PRI, *Fiduciary Duty in the 21st Century Final Report*

[7] Quigley, E. (2020) *Universal Ownership in Practice: A Practical Positive Investment Framework for Asset Owners*. Hawley, J. and Lukomnik, J.(2018), "The Long and Short of It: Are We Asking the Right Questions? Modern Portfolio Theory and Time horizons", *Seattle University Law Review 41, 449*.

[8] For more information on how investors could exercise stewardship to shape investment outcomes please see the PRI report *Investing with SDG Outcomes: a five-part framework*. For discussions on policy reform to facilitate investment for sustainable impact, please see the PRI report *A Legal Framework for Impact*.

LATEST TRENDS

Recent developments in stewardship have seen its application to a broader range of issues.

Coverage across asset classes

Although stewardship was first applied to listed equities, it can be practiced across many asset classes. Listed equity investors can use their position as shareholders of companies to influence what activities those companies engage in and how they behave and operate. Fixed income investors are equally important stakeholders with influence over issuers and clearly defined legal rights. Fixed income investors can therefore interact with issuers to address how they behave and operate.[9] Private market investors, in particular those with direct exposure to private equity or real assets, are in a unique position when it comes to stewardship, as they often have controlling interests in their portfolio companies or investments, and positions on portfolio company boards.[10]

PRI technical guides for ESG stewardship:

Listed equity
Fixed income
Sovereign debt
Private equity
Infrastructure
Real estate
Forestry

Expansion of stewardship practices amongst passive investors

The stewardship activities of passive investors have become increasingly important as the assets in these strategies continue to grow. In recent years, large passive investors have expanded their stewardship and corporate governance teams.[11] One of the key drivers for this development is the need to optimise risk and return where passive investors' ability to diversify away from particular companies or sectors is limited.[12]

> "Engagement is particularly important for our clients invested in index strategies, which represent a significant portion of BlackRock's equity investments. Because index funds are designed to track the investment results of indices that are created by third-party index providers, BlackRock does not have the discretion to divest from companies in our index strategies."
>
> **BlackRock**

Increased focus on ESG factors

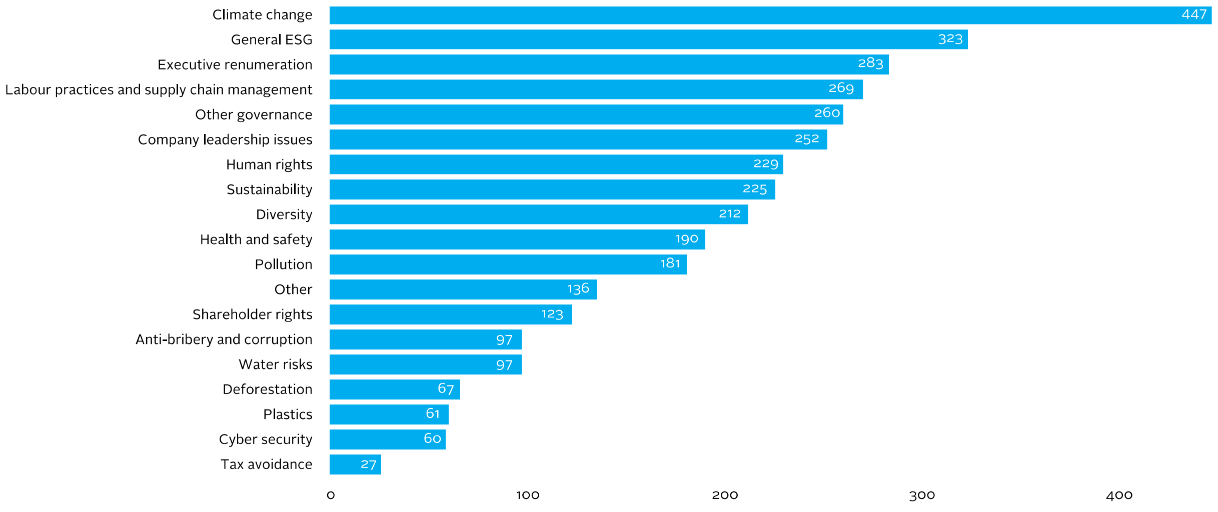
A major factor in the development of stewardship is an increased focus on sustainability and ESG issues. This is due, among other things, to: widespread recognition of the materiality of ESG factors for long-term company performance; an increasing desire by universal owners to influence sustainability outcomes; and growing demand from beneficiaries and clients with clear sustainability preferences. Stewardship and ESG incorporation (which involves investors including ESG factors in their investment and capital allocation decisions) are regarded as complementary strategies to enhance institutional investors' decision making.

[9] PRI, *ESG Engagement for Fixed Income Investors*
[10] PRI, An Introduction to Responsible Investment: Stewardship.
[11] Bioy, H., Garcia-Zarate, J., and Bryan, A. (2017), *Passive Fund Providers and Investment Stewardship*.
[12] Cook, J. and Sethi, J. (2019), *The Stewardship Implications of Passive Investing: Mobilizing Large Asset Managers as Stewards of Capital Markets*. PRI, "How can a passive investor be a responsible investor?"

Table 2: ESG incorporation and stewardship as complementary strategies[13]

CONSIDERING ESG ISSUES WHEN BUILDING A PORTFOLIO (known as: ESG incorporation)			**INTERACTING WITH ISSUERS ON ESG ISSUES** (known as: active ownership or stewardship)	
ESG issues can be incorporated into existing portfolio construction practices using a combination of three approaches: integration, screening and thematic.			Investors can exert influence through tools including: engagement and voting – two of the most widely used tools – resolutions/ proposals, board roles, supplier monitoring/negotiation, contributing to research and public discourse, litigation.	
Integration	**Screening**	**Thematic**	**Engagement**	**Voting**
Explicitly and systematically including ESG issues in investment analysis and decisions, to better manage risks and improve returns.	Applying filters to lists of potential investments to rule companies in or out of contention for investment, based on an investor's preferences, values or ethics.	Seeking to combine attractive riskreturn profiles with an intention to contribute to a specific environmental or social outcome. Includes impact investing.	Interactions between an investor and current or potential investees/issuers, in order to: improve practice on an ESG issue, change a sustainability outcome in the real world or improve public disclosure. Engagement can also be with non-issuers, such as policy makers or standard setters.	Exercising voting rights on management/ shareholder resolutions (and submitting resolutions), to formally express approval (or disapproval) on relevant matters.

Chart 2: The number of PRI signatories providing examples of engagement on ESG issues[14]



The indicator was voluntary. Signatories were asked to provide examples of the engagements that they or their service providers carried out during the reporting year

[13] PRI, An Introduction to Responsible Investment: Stewardship.
[14] PRI, Listed Equity Snapshot 2017-2020.

An increased focus on delivering sustainable outcomes

As a result of the interdependence between financial and economic activity and the social and ecological systems on which such activity relies, there has been an increasing focus on the financial community as a source of solutions to systemic sustainability and market stability challenges.[15] The primary evolution that is occurring is that investors are increasingly going beyond a narrow risk-management and process-driven paradigm to an approach intended to deliver and shape sustainability outcomes. This is particularly important for universal owners with broadly diversified portfolios but is arguably relevant for all investors. Leading investors have been pioneering innovative strategies to address systemic ESG issues, such as climate change, by employing a wide range of levers or tools[16] to influence key stakeholders to improve their performance on a variety of sustainability issues.[17] Climate Action 100+ offers an example that illustrates this development (see Box).

An example of stewardship practices to address climate change: Climate Action 100+

Launched in December 2017, Climate Action 100+ (CA 100+) is an investor initiative composed of more than 610 investors, responsible for over US$55trn in assets under management.

Recognising their exposure to climate risks and their fiduciary duty to respond, CA 100+ signatory investors are exercising stewardship to mitigate investment exposure to climate risks and secure ongoing sustainable returns.

CA 100+ investors are engaging with 167 of the world's largest corporate greenhouse gas (GHG) emitters, which are responsible for 80% of global industrial emissions, to:[18]

- improve their climate change governance, including board oversight and climate-related competencies, remuneration arrangements and policy engagement.
- make net-zero GHG emission commitments and develop decarbonisation strategies aligned with the Paris Agreement; and
- strengthen climate-related financial disclosures aligned with the Task Force on Climate-related Financial Disclosures.

If engagement does not go well, investors will take escalating measures to influence their investees and clarify their expectations in order to fulfil their fiduciary duties by, for example, voting at general meetings, submitting shareholder resolutions/proposals or, ultimately, by divesting.

By working together through the CA 100+ initiative, investors can accelerate the business transition to a net-zero emissions future and, in turn, help secure stable economies that are more resilient to the risks posed by climate change.

As of the end of 2020, many companies engaged by CA 100+ had made net-zero commitments. For example, BP set a new ambition to become a net-zero emissions company by 2050 for its Scope 1, 2 and 3 emissions, with a 50% cut in the carbon intensity of products it sells by 2050 or sooner. PetroChina also announced a near-zero emissions target by 2050 and plans to use some of the US$38bn earned from gas pipeline sales to focus on wind and solar power. Sinopec also announced that it aims to achieve net-zero emissions by 2050. Half of the CA 100+ companies had set a net-zero target for 2050, or a similar target, by the end of 2020, sending an important signal to investors that companies understand the importance of transformation and are already preparing for it.

---

[15] PRI, *A Legal Framework for Impact.*
[16] For example, voting, engagement, collaboration and coordination between investors, engagement with policy makers, etc.
[17] PRI, Active Ownership 2.0 .
[18] See CA 100+ net zero company benchmark.

2. THE DEVELOPMENT OF STEWARDSHIP CODES

Investor engagement can result in both positive and negative influences on corporate behaviour, research shows.[19] To encourage institutional investors to engage with investees in a constructive and responsible manner, and not to excessively focus on short-term results, investor stewardship should be framed within the limits of investor fiduciary duties and regulatory oversight and expectations of stewardship activities should be strengthened. To this end, stewardship codes have been developed in many countries to supplement overarching regulatory frameworks and codify the key institutional investor responsibilities that come with investor rights and influence, and to provide guidance towards effective stewardship practices.

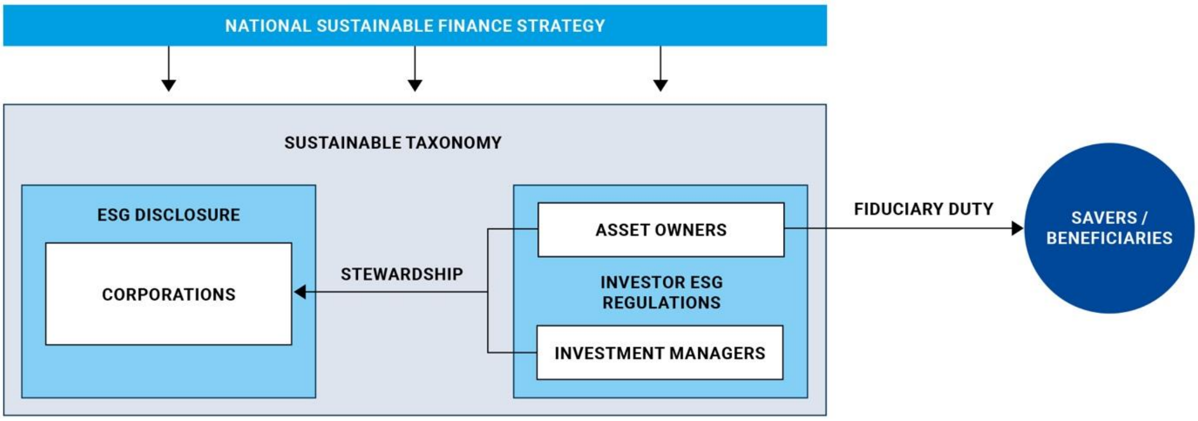
The development of stewardship codes has also coincided with the development of sustainable investment policies and regulations across the globe.[20] Stewardship codes have therefore been introduced or revised to encourage investors to use their influence to address ESG issues and, in particular, systemic risks. As suggested by a recent PRI and World Bank report, stewardship codes could, together with other key policy tools, help to direct capital to support the sustainable development of the economy by aligning investment decisions and stewardship activities with sustainability objectives.[21]

[19] Jennifer G. Hill, Good Activist/Bad activist, the Rise of International Stewardship Codes. Yanfeng Liu, Shareholder Activism by Institutional Investors: International Practices and Chinese Approach, Investors, vol. 9, 165.
[20] PRI, "88 new policies added to PRI's regulation database".
[21] PRI and World Bank Group, *A Toolkit for Sustainable Investment Policy and Regulation*.

Chart 3: Priority elements of sustainable investment policy and regulation

Sustainable investment policy and regulation need to cover the following five areas:

- Corporate ESG disclosures, including alignment with the recommendations of the Task Force on Climate-Related Financial Disclosures
- Stewardship (engagement and voting)
- Investors' duties to incorporate ESG-related considerations in their investment decision making, to provide sustainability-related disclosures and to report on their ESG incorporation policies and performance targets
- Taxonomies of sustainable economic activities, defining common and clear criteria to classify projects or investment as green or sustainable
- National/regional sustainable finance strategies that encourage and enable the low-carbon transition and the delivery of the Sustainable Development Goals



Source: The PRI and the World Bank[22]

[22] ibid.

A COMPARATIVE PERSPECTIVE

Since the first stewardship code was adopted by the UK Financial Reporting Council in 2010, stewardship codes have been introduced in 23 countries and regions.[23] At the multilateral level, major principles of stewardship have been endorsed by the G20/OECD Principles of Corporate Governance.[24]

While it is possible to identify some consistent principles, different countries have adopted slightly different approaches, based on local market dynamics and regulatory frameworks. Examples of stewardship codes are included below to offer insights for industry bodies and regulators in China as they consider improvements to the regulatory framework for effective stewardship, including the adoption of stewardship codes.

The UK Stewardship Code (2010, 2012, 2020)

The introduction of the first stewardship code in 2010 was based on the lessons learned from the 2008 financial crisis. Insufficient engagement by shareholders in corporate governance and investor short-termism were identified as contributing factors to the global financial crisis. Stewardship was recommended as one of the solutions to address the systemic problems of the financial sector.[25] UK policy makers believed that effective engagement would help restore a relationship of trust and confidence across the investment chain and provide the foundation for a longer-term perspective in UK equity markets, promoting more responsible corporate behaviour.

Major revisions were made to the code in 2020, including the introduction of disclosure requirements covering actions and outcomes of stewardship, the extension of the code to service providers and to asset classes beyond listed equity, and including explicit reference to incorporating systemic ESG issues, including climate change, into investment and stewardship decisions. These were designed to align the approach of the whole investment chain with the interests of end-investors and beneficiaries.

Japan: Principles for Responsible Institutional Investors (2014, 2017, 2020)

The approach in Japan was slightly different from that in the UK. The introduction of a stewardship code there was part of the broader plan to reform the corporate governance of Japanese listed companies and to promote innovation and the sustainable development of Japan's economy. The problem identified by Japanese experts was not excessive risk-taking by Japanese investors, rather it was the corporate governance of listed companies in Japan that had long been characterised by cross-shareholdings, traditional lifetime-employment and stakeholder-oriented governance. Such governance characteristics effectively insulated managers from accountability to capital markets and therefore resulted in managerial slack and inefficiency.[26] The stewardship code was introduced to encourage institutional investors to engage with corporate managers and to stimulate innovation and accountability, including in relation to ESG factors.

---

[23] Countries and regions that have adopted a stewardship code include the UK, the EU, Netherlands, Australia, Denmark, Kenya, South Africa, Singapore, Hong Kong SAR, Malaysia, Switzerland, Canada, USA, Germany, Italy, Norway, Brazil, South Korea, Japan, Thailand, India and Russia.
[24] OECD (2015), G20/OECD Principles of Corporate Governance, OECD Publishing, Paris.
[25] Walker, D. (2009) A Review of Corporate Governance in UK Banks and Other Financial Industry Entities, Kay, J. (2012) *The Kay Review of UK Equity Markets and Long-term Decision Making*.
[26] Goto, G. (2019) "The Logic and Limits of Stewardship Codes: The Case of Japan", *Berkeley Business Law Journal*, Vol.15, No.2, 37.

Australia: Principles of Internal Governance and Asset Stewardship (2017)

The Financial Service Council (FSC) in Australia established a stewardship code[27] for its asset manager members to encourage higher standards of internal governance and stewardship practices, provide better information for clients and other stakeholders, and improve the quality and standing of Australia's financial services internationally.[28] As an industry body, the FSC's focus is on strengthening the competitiveness of Australia's asset managers, as opposed to the broader purpose found in the UK and Japanese codes, which is to support the sustainable development of the economy. Asset managers are in a key position, serving as the custodians of capital on behalf of their clients. The FSC Code was intended to help its members succeed in the competition for clients by facilitating demonstration and disclosure of their commitment to responsible management and robust corporate governance practices.

US: The governance of proxy voting and related stewardship activities

In the US, in addition to investor-driven stewardship principles,[29] financial regulators have developed a mandatory regulatory framework to govern proxy voting and related stewardship activities, which covers key elements of a stewardship code.

Given the enormous influence of institutional investors in the capital markets and on the fortunes of their beneficiaries, both the US Department of Labor (DoL) and the Securities and Exchange Commission (SEC) regulate proxy voting by institutional investors within the framework of fiduciary duty.[30] In the case of an individual investor, it is within their rights as a shareholder to submit a shareholder proposal and to vote the proxies of the companies they own.[31]

Regarding proxy voting, institutional investors are obliged to establish policies and procedures to ensure they monitor investees and vote client or beneficiaries' proxies, resolve conflicts of interest so that votes are cast in the best interests of clients or beneficiaries, keep records of proxy voting and make disclosures and monitor proxy advisors. In October 2021, the DoL proposed revisions to the Employee Retirement Income Security Act of 1974 (ERISA) to address barriers to ESG considerations and provide clarity to fiduciaries on how to consider ESG factors in investment decision making and the proxy voting process.[32]

[27] There are two stewardship codes in Australia. The Financial Service Council (FSC) published the principles of Internal Governance and Asset Stewardship in 2016 which applies to FSC members, largely asset managers. The Australian Council of Superannuation Investors published the Australian Asset Owner Stewardship Code in 2018.
[28] FSC Standard 23: Principles of Internal Governance and Asset Stewardship, 3.
[29] The Investor Stewardship Group, Stewardship Principles of Institutional Investors.
[30] See the Employee Retirement Income Security Act of 1974 (ERISA), Investment Advisers Act of 1940 and Investment Company Act of 1940, Proxy Voting by Investment Advisors (2003), Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies (2003). Also see *Interpretive Bulletin 2016-01, 81 FR 95879 (Dec. 29, 2016); Proxy Voting by Investment Advisors No. IA-2106.*
[31] Rule 14a-8 under the Securities Exchange Act of 1934. Latest developments in the regulation of shareholder voting include the Dodd-Frank Act, which requires company management to offer a mandatory, non-binding resolution on the compensation package for the company's executive officers and ask shareholders to approve, which is also known as "say on pay", see Dodd-Frank Wall Street Reform and Consumer Protection Act (enacted in 2010, and amended in 2020)
[32] Employee Benefits Security Administration (2021), Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights; Fact Sheet on the proposed rulemaking.

Although the UK and Japan adopted stewardship codes or principles for slightly different reasons, their objectives converged in their goal of guiding the financial sector to support the sustainable development of the economy. China not only shares this ultimate objective but is also familiar with the problems that occurred in the UK and Japan. In response to the rapid expansion of the investment sector in China, it is equally important for Chinese regulators to establish an effective regulatory framework to guide institutional investors to exercise the rights and responsibilities associated with their assets (including voting rights) in the best interests of their clients or beneficiaries. As the fast-growing Chinese asset management sector is seeking to attract more long-term capital, it would also benefit directly from a stronger regulatory framework and a formal stewardship code to help firms enhance and communicate the quality of their financial services, both domestically and internationally.

COMMON PRINCIPLES OF STEWARDSHIP CODES

Despite different capital markets and regulatory contexts, most stewardship codes share a set of core principles or elements. These include:[33]

- **Principle 1:** Clear definitions of investor stewardship duties and obligations and requirements for investors to set out how they implement their stewardship obligations as part of their fiduciary duties to beneficiaries and clients. Typically, these include expectations for investors to individually or collaboratively exercise their stewardship obligations by, for example:
  - diligently monitoring portfolio companies;
  - engaging with companies in which they invest or intend to invest, and with other stakeholders; and
  - exercising delegated investors' rights, including the right to vote and to file shareholder resolutions, etc.
- **Principle 2:** Expecting investors to ensure their governance, resources, incentives and capacities support stewardship that is aligned with the (generally long-term) time horizons and preferences of the ultimate beneficiaries of the capital they manage.
- **Principle 3:** Expecting that ESG considerations are integrated into stewardship practices.
- **Principle 4:** Establishing a policy and disclosing how investors manage conflicts of interest.
- **Principle 5:** Requiring alignment of stewardship responsibilities along the investment chain, including the responsibilities of asset owners, asset managers and service providers.[34]
- **Principle 6:** Recommending participation in collaborative engagement.
- **Principle 7:** Reporting to clients and beneficiaries on how investors have fulfilled stewardship responsibilities.

To enhance the effectiveness and quality of stewardship, some revisions have been made to existing principles. For example, for the reporting requirement, the UK code shifted from requiring the reporting of stewardship policies to the disclosure of actions that have been taken and outcomes achieved to fulfil stewardship responsibilities. For ESG integration in stewardship activities, some codes now specifically encourage investors to respond to market-wide and systemic issues.

[33] PRI and World Bank Group, *A Toolkit for Sustainable Investment Policy and Regulation*, 15; see also CFA Institute, *Stewardship 2.0*.
[34] For example, the UK code (2020) explicitly sets out stewardship requirements for asset owners, asset managers and service providers.

PART II: THE VALUE OF ESTABLISHING A STRONGER REGULATORY FRAMEWORK FOR EFFECTIVE STEWARDSHIP IN CHINA

3. OVERVIEW OF THE CHINESE INVESTMENT LANDSCAPE AND REGULATORY TRENDS

In recent years, the size and sophistication of financial markets and institutional investors in China have increased dramatically. This has been accompanied by a wide range of regulatory reforms and developments to ensure that financial services are delivered in the interests of clients and beneficiaries and aligns with overall sustainability and economic development goals. Among other things, this has included a wide range of improvements to the regulatory framework to support sustainable investment.

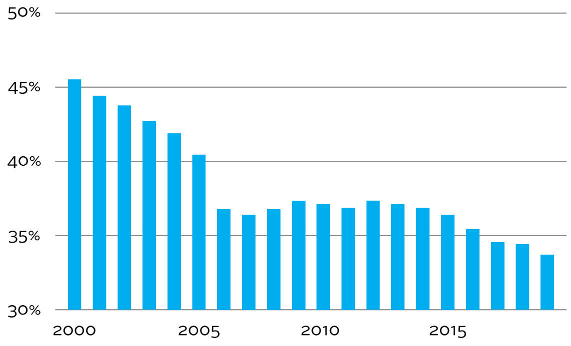
So far, adequate regulatory oversight to guide and support more effective stewardship practices in China is yet to develop. However, as shown in the case studies prepared by the PRI for this report, many market participants are increasingly pursuing a wide variety of stewardship practices in China, including in relation to ESG factors and sustainability outcomes. A stronger regulatory framework for stewardship, including the adoption of a stewardship code, could better support effective investor stewardship activities that lead to improved investment returns and outcomes for investors, companies, clients and beneficiaries alike.

MARKET CONDITIONS

Benefiting from years of rapid growth in the Chinese economy, the Chinese asset management industry has become one of the world's largest, with assets under management by institutional investors (including the asset management branches of banking, insurance, fund, trust and securities companies) reaching US$16trn by the end of 2019.[35] Meanwhile, it is also important to note that the level of ownership concentration in China's A-shares listed companies has been steadily declining, from over 45% in 2000 to around 34% in 2019. Institutional ownership has also surged, to around 50% of free-float shares in 2020 from less than 10% in 2003.[36]

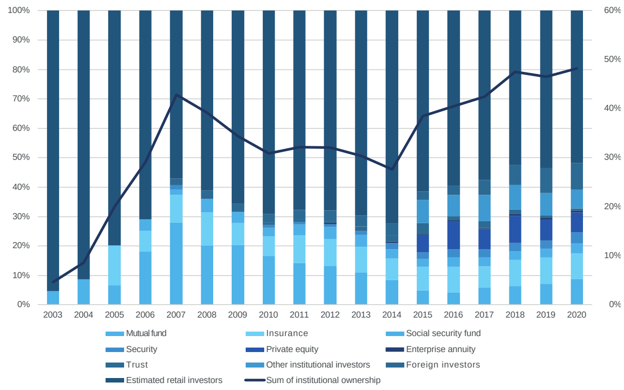
[35] The World Economic Forum, *China Asset Management at an Inflection Point*
[36] Fidelity International and ZD Proxy Shareholder Services, Building Solid Foundations: China Stewardship Report 2020.

Chart 4: Average controlling interest as a % of total shareholding declines across all A-shares in China



Source: Fidelity International, ZD Proxy, Wind. [China Stewardship Report 2020](#)

Chart 5: Institutional ownership rises across all A-shares in China (as a % of free float)



Source: [CICC](#), July 2020.

In addition, studies have found that shareholders are exerting more sway in Chinese companies by stepping up their voting and engagement activities.[37] With China further reforming and opening up its financial sector, it is likely that institutional investors will exert increasing influence on the real economy.

There are certain characteristics of the ownership structure of A-shares-listed companies in China that are important to consider when assessing the likely influence of institutional investors in the coming years. First, a relatively large number of A-shares companies have controlling shareholders. As of end of 2017, the percentage of A-shares companies where the three largest shareholders hold more than 50% of the shares stood at 57%.[38] In addition, around 37% of listed companies in China have a public sector investor as its largest investor.[39] These features inevitably make the role and influence of institutional investors in the corporate governance of Chinese listed companies substantially different from those in other markets where the concentration of ownership is much lower.[40]

However, despite this local nuance, PRI case studies on investor stewardship in China have demonstrated that institutional investors can still play an important role in monitoring and supporting better corporate governance and sustainability outcomes at investee companies. It is therefore important for institutional investors and Chinese policy makers to take action to unlock the potential of investors' influence to drive sustainable growth of investee companies and deliver positive investment impacts, in a way that is appropriate to China's market structure and regulatory landscape.

---

[37] Ibid.
[38] Puchniak, D.W. (2021) The False Hope of Stewardship in the Context of Controlling Shareholders: Making Sense Out of the Global Transplant of a Legal Misfit, Working Paper 589/2021, 45-46.
[39] Ibid, 48.
[40] For example, in the UK, the three largest shareholders hold more than 50% of the shares of only 12% of listed companies. In the US, the figure is just 4% (see Puchniak, above). See Lin and Puchniak's research for a detailed analysis on the role of institutional investors in the corporate governance of Chinese listed companies. Lin Lin and Dan W. Puchniak, Institutional Investors in China: Corporate Governance and Policy Channelling in the Market Within the State.

RECENT REGULATORY REFORMS

China has long adopted the principle of segregated operations to regulate financial institutions. The regulation of the investment industry is therefore characterised by multi-sector regulatory oversight. As a result, the relationship between an institutional investor and a client or beneficiary may be governed by different laws and regulations, depending on the types of asset manager involved. Some investors have taken advantage of this segregated regulation framework and engaged in regulatory arbitrage through highly risky investment practices such as channel business (*tongdao yewu*) [41] and shadow banking.

In 2018, to address these problems, the People's Bank of China (PBOC), China Banking and Insurance Regulatory Commission (CBIRC), the China Securities Regulatory Commission (CSRC), and the State Administration of Foreign Exchange jointly published Guidelines on Regulating the Asset Management Business of Financial Institutions (also known as the New AM Regulation).[42] For the first time, Chinese financial regulators collaborated in standardising the responsibilities and duties of asset managers to create a level playing field across the diverse asset management industry to encourage prudent and responsible practice. These measures laid the foundation for clarifying the stewardship responsibilities of institutional investors related to their management of client or beneficiaries' assets and investor rights.

Alongside these fundamental responsible investment issues, Chinese regulators have increasingly recognised the need for investors to manage ESG risks and influence the broader economic, social and environmental system. In response to the rapid expansion of the investment sector, China's regulators have set high expectations on investors to address ESG issues, such as carbon neutrality goals, poverty alleviation and improving the corporate governance of Chinese listed companies. Table 3 provides examples of key ESG issues that have been reflected in financial policy reforms.

Table 3: Examples of Chinese policies calling for financial solutions to ESG issues

ESG issues	Policies calling for financial solutions
Climate change and environmental protection	Guidelines on Establishing a Green Financial System Guidelines on Facilitating Investment and Financing for Addressing Climate Change
Social development	Guidelines on fully Improving Financial Services for Poverty Alleviation and Development
Corporate governance	State Council Opinions on Further Improving the Quality of Listed Companies

[41] This involves heavily regulated investors (usually banks and insurance companies) investing in financial products (usually offered by trusts, securities companies, mutual funds and private equity firms) so that the money can then be channelled to projects in which those investors are not allowed to invest directly.
[42] The Guiding Opinions of the People's Bank of China (PBoC), the China Banking and Insurance Regulatory Commission (CBIRC), the China Securities Regulatory Commission(CSRC), and the State Administration of Foreign Exchange (SAFE) on Regulating the Asset Management Business of Financial Institutions (New AM Regulations), para 8.

A GRADUALLY IMPROVED REGULATORY FRAMEWORK FOR SUSTAINABLE INVESTMENT

Chinese financial policy makers have initiated policy reforms in several key areas, such as ESG disclosure and green bonds. Table 4 summarises key developments mapped against foundational sustainable finance policy reforms. Compared with other key areas, the value of a stewardship code and investor duties have received less attention thus far from policy makers and financial regulators.

Table 4: Mapping key regulatory developments in China against priority elements of sustainable investment policies and regulations

Priority elements of sustainable investment policies	Key regulatory development
Corporate ESG disclosure rules	■ CSRC updated reporting guidance for listed companies by adding a chapter on corporate governance and a chapter on environmental and social responsibility [43] ■ The Ministry of Ecology and Environment (MEE) introduced disclosure rules for enterprises' environmental information[44]
Stewardship code	■ Industry-driven guidelines on proxy voting for fund managers[45]
Investor duties to exercise ESG incorporation and disclosure rules	■ Industry-driven guidelines on investor ESG incorporation for asset managers[46]
Taxonomy for sustainable economic activities	■ PBOC, the National Development and Reform Commission and CSRC updated the Green Bond Endorsed Projects Catalogue (2021)[47] ■ International Platform on Sustainable Finance on Common Ground Taxonomy (co-chaired by EU and China)[48]
National sustainable finance strategies	■ Guidelines on Establishing a Green Financial System[49] ■ The Guidelines for Promoting Investment and Financing in Response to Climate Change[50]

[43] Standards Concerning the Contents and Formats of Information Disclosure by Companies Offering Securities to the Public No.2 — Contents and Formats of Annual Reports (No.2 document), and No.3 — Contents and Formats of Semi-Annual Report (No. 3 document).
[44] MEE, Administrative Measure of the Legal Disclosure of Enterprises' Environmental Information.
[45] AMAC, Guidance on Fund Managers Exercising Voting Rights on behalf of Funds.
[46] AMAC, Green Investment Guideline (Trial) .
[47] PBoC, NDRC, and CSRC, Green Bond Endorsed Projects Catalogue (2021).
[48] International Platform on Sustainable Finance on Common Ground Taxonomy – Instruction Report
[49] PBoC, MoF, NDRC, MEE, CBRC, CIRC (now CBRC and CIRC merged into CBIRC) and CSRC, Guidelines on Establishing a Green Financial System.
[50] MEE, NDRC, PBoC, CBIRC and CSRC, Guidelines on Promoting Investment and Financing in Response to Climate Change.

THE VALUE OF AND CHALLENGES TO EFFECTIVE STEWARDSHIP IN CHINA – FINDINGS FROM PRI CASE STUDIES

In preparing this report, the PRI invited nine signatories to provide case studies of their stewardship activities, hoping to identify the perceived value of effective stewardship as well as challenges to exercising stewardship in China. Case study participants were asked to respond to a set of questions regarding their stewardship practices. Their responses demonstrate great diversity in their stewardship approaches commensurate with the nature, size, complexity and risk profiles of the firms involved and the investment strategies adopted for different financial products. The case study participants were:

Case study participant	HQ country	Asset classes and investment strategies covered in the case study	ESG issues
BlackRock	US	Listed equity (index investing)	Natural capital and impacts on indigenous groups
BPEA	Hong Kong SAR	Private equity (mid- and large-cap buyouts)	Plastics
ChinaAMC	China	Listed equity (active investing)	Climate change and responsible marketing
E Fund	China	Listed equity (active investing)	Corporate governance
EOS Federated Hermes	UK	Listed equity	Human capital and corporate governance
Fidelity International	UK	Listed equity (active investing)	Packaging and safety management
Harvest Investment Fund	China	Listed equity	Climate change
Manulife Investment Management	Canada	Listed equity and fixed income	Gender diversity in corporate governance
Southern Asset Management	China	Fixed income	Animal health and environmental protection

A summary of key findings from these case studies are included below, along with a selection of quotes from the case studies. These include why investors practice stewardship in China, how they take account of local nuances, the challenges they have encountered and the solutions they have identified to address those challenges.

Why practice stewardship in China?

Case study participants expressed varied reasons and values underpinning their stewardship activities. These include:

> "But in markets where most companies are just starting out on this journey, such as China, stewardship plays an even more significant role. This is because most companies well understand the importance and ever-increasing business relevance of their sustainability practices but need guidance or even handholding as they get started."
>
> **Fidelity International**

- To enhance mutual trust and confidence between investors and investees as a constructive process of investee education, building in-depth understanding of investees and clarifying investor expectations.
- To support long-term sustainable value creation: many investors identified clear links between stewardship activities that help identify sustainability-related opportunities and long-term investment returns.
- To manage and mitigate risks, including ESG-related risks, systemic risks and risks of green and social washing.
- To discharge fiduciary duties to clients, especially where institutional investors are subject to clear regulations requiring or encouraging stewardship activities.
- To shape investment impacts aligned with sustainability objectives, such as climate change mitigation, protecting aboriginal culture, or enhancing consumer and employee welfare.

> "As stewards of our clients' investments, we have a responsibility to maintain constructive relationships with the companies in which we invest on our clients' behalf. To that end, we aim to represent the voice of the long-term investor and are interested to hear from companies about how they focus on the governance and sustainability risks and opportunities that can impact their ability to generate durable, long-term financial returns."
>
> **BlackRock**

How do they pursue stewardship in China?

Key features of participants' stewardship approaches in China are summarised below, based on the PRI case studies.

Tools

Although shareholder resolutions, particularly on ESG issues, are still quite rare in China, case study participants have adopted a variety of stewardship tools, including engagement, proxy voting, collaborative engagement, letters to chairs or board of directors, site visits and assuming board roles. Collaborative engagement is cited by some participants as an effective lever when institutional investors only hold a minority share. Some participants also mentioned they would consider pursuing escalation strategies in case of unsuccessful initial engagement.

> "We set engagement targets by identifying relevant industry- and business-specific issues critical to the company's long-term growth in terms of key opportunities to capture or risks to mitigate. In conducting engagement sessions, we set priorities based on a materiality assessment and formulate an engagement programme to address these issues over the short, medium and long term by crafting customised roadmaps."
>
> **Harvest Investment Fund**

> "The right to vote is a basic component of share ownership and is an important control mechanism to ensure that a company is managed in the best interests of its shareholders. Where clients delegate proxy voting authority to Manulife IM, we have a fiduciary duty to exercise voting rights responsibly."
>
> "For the companies we engage with, collaborative efforts reduce the noise of numerous points of view, helping to focus on goal-setting and real outcomes."
>
> **Manulife investment management**

> "With a strategy focusing primarily on mid- and large-cap buyouts, we use our controlling stake and position on the board to ensure ESG stays on the board agenda and permeates the entire organisation."
>
> **BPEA**

Governance

Based on the experience of international case study participants, the level of transparency, quality and accountability of stewardship practices benefit substantially from comprehensive internal governance. For example, well-established policies setting out how they normally engage and vote proxies are publicly disclosed and regularly updated; stewardship teams (or teams of similar functions) are well staffed and provided with sufficient resources; engagement, proxy voting and third-party services are subject to oversight from senior management to prevent conflicts of interest and ensure accountability to clients/beneficiaries, and voting records are publicly disclosed. Many Chinese participants have taken the initiative to improve stewardship governance, but systemic changes across the industry will likely depend on clear policy guidance or requirements.

Integration of stewardship and investment

In most cases, stewardship and investment have been well integrated in terms of structure, process and outcomes. Participants have typically developed internal processes and structures to enable effective partnerships between stewardship and investment teams. They have also supported engagement and proxy voting with in-depth and long-term investment research of targeted investees. According to the experiences of participants, progress in stewardship, in turn, strengthens mutual trust between investors and investees and further informs investment decisions that support the long-term sustainable growth of portfolio companies.

Who to engage with?

In several cases, investors have established proprietary processes or systems to select companies for engagement and set engagement milestones or targets. Although engaging with portfolio companies to enhance their sustainability performance remains the priority for investors, some have taken actions to engage with policy makers and other stakeholders in the public policy sphere to address systemic issues that may have market-wide impacts.

"Where we identify gaps between the company's approach and our expectations regarding environmental, social or corporate governance issues, we may engage with the company to support its long-term development and value creation. This can occur either with investees who violate the principles and expectations described in our Responsible Investment Statement, investees for whom we identify opportunities for enhanced value creation through improved practices, or companies we would potentially invest in once relevant ESG issues are addressed."

E Fund

Topics

Stewardship on corporate governance, climate change mitigation and environmental protection, unsurprisingly, are the most common topics raised. Social issues such as human capital, gender diversity and key stakeholders' interests are also gaining wider recognition.

> "We find that engagement on environmental and governance concerns is more straightforward than engagement on social matters, although companies are becoming more willing to discuss issues around human capital management. We are keen to make progress on the 'S' pillar and continue to raise these issues, with cultural sensitivities in mind."
>
> **EOS at Federated Hermes**

Impacts

Participants highlighted that the impacts of stewardship may take time to manifest themselves and some ESG issues need to be addressed using a phased approach. Given that many investors and companies in China have just started out on their sustainability journeys, most progress so far has been seen in helping investee companies identify material ESG factors, improve ESG disclosure and ratings, upgrade sustainability commitments, formulate strategies to actively manage ESG-related risks and opportunities, and eliminate the principle adverse impacts on the environment and key stakeholders. As sustainable investment and policy reforms continue to develop in China, many participants expect further progress in delivering concrete sustainability outcomes.

> "SAM set up an internal carbon emissions database to track the carbon footprint of our portfolios and continued engaging with portfolio companies with significant carbon emissions to support their journey towards decarbonisation."
>
> **Southern Asset Management**

A localised approach

To improve the effectiveness of stewardship, many participants recognise the need to take a localised approach to stewardship in China. This may include, for example, being able to communicate with investee companies in Chinese, understanding which engagement and voting techniques are appropriate to China, keeping in mind local cultural sensitivities, customising stewardship strategies to different types of companies (particularly private-owned and state-owned companies), and partnering with local asset managers.

> "To alleviate investee companies' potential anxiety or discomfort regarding certain issues, we customise engagement strategies for each company based on its ownership structure, development trajectory and industry environment."
>
> **ChinaAMC**

Challenges and solutions

While market practice and regulatory frameworks for stewardship in China are still emerging, particularly in relation to systemic ESG issues, investors have identified the following major barriers to more effective stewardship:[51]

- **Lack of clear stewardship guidance or requirements:** This is particularly so when it comes to investor obligations to exercise stewardship and the legality of certain stewardship activities. This perceived ambiguity might discourage investors from actively pursuing stewardship. Some market participants have called for the introduction of stewardship codes and necessary regulatory clarifications to encourage systemic stewardship actions across all institutional investors and normalise engagement channels and stewardship strategies.

- **A high level of ownership concentration**: With many A-share companies dominated by controlling shareholders, the influence and power of minority shareholders is relatively limited. While calling for stronger protection of shareholder rights and regulatory oversight of controlling shareholders, many institutional investors have identified that collaborative engagement and building long-term relationships with investees could substantially enhance the effectiveness of stewardship actions.

- **Corporate responsiveness**: Given that ESG investment and stewardship are still at a relatively early stage in China, it is understandable that some companies do not respond positively to investors' suggestions or inquiries on ESG issues. ESG-related policy development will be needed to enhance ESG awareness. In the meantime, investors have undertaken initiatives to explore strategies and ways to engage in constructive dialogue with investees on ESG issues. For example, case study participants noted that investee education and relationship management are crucial parts of engagement, especially during the first few meetings.

- **Insufficient enabling tools/environment to address ESG issues**: The lack of standardised and internationally aligned mandatory ESG disclosure at a corporate level increases the costs for stewardship because investors have to expend significant effort to collect relevant information. Other important enabling tools identified include a taxonomy aligned with sustainability objectives and science-based climate transition pathways, aligned with the Paris Agreement or nationally determined contributions, to help investors develop evidence-based stewardship strategies to support investees in addressing ESG issues. Most of these resources fall within the scope of public goods which may need government support and collective action from the market.

- **Costs and free-riding problems**: Building a dialogue with companies and voting shares in an informed way takes resources and time. Moreover, the cost can be borne by a few investors while many could potentially benefit once companies have improved their practices. Some investors have therefore called for clear policy that encourages or requires all investors to exercise stewardship and make appropriate disclosures about how they have done so.

[51] For this section, findings from PRI case studies have been supplemented with findings from discussions at the ESG stewardship workshop co-hosted by the PRI and the Beijing Institute of Finance and Sustainability in December 2021.

- **Insufficient stewardship demands from domestic asset owners**: Participants have raised concerns regarding a lack of clear stewardship demands from domestic asset owners. This could be improved by clarifying that asset owners' duties may include conducting effective stewardship to monitor and urge investees to manage ESG-related risks and opportunities in the interests of their beneficiaries.

- **Underdeveloped internal governance**: Limited senior management supervision, time-consuming voting process, and insufficient resources or capacity can discourage stewardship. While many Chinese market participants have taken the initiative in improving internal governance and streamlining processes to support effective stewardship, systemic changes will depend on clear policy guidance or requirements.

- **Stewardship infrastructure needs further improvement**: This may include improving the interoperability of different jurisdictions' voting and reporting systems and coordinating or facilitating collaborative engagement. While most of the case study participants have participated in collaborative or parallel engagement convened or supported by the Climate Action 100+, there is strong demand for local initiatives to support and facilitate collaborative engagement in China.

Many of the challenges identified above are not unique to China.[52] To address them, as has been identified by case study participants, a key step to take is to establish a stronger regulatory framework for effective stewardship.

[52] PRI, *A Practical Guide to Active Ownership in Listed Equity*, 19.

4. THE ADDED VALUE OF ESTABLISHING A STRONGER REGULATORY FRAMEWORK FOR EFFECTIVE STEWARDSHIP

A clear and strong regulatory framework for effective stewardship, supported by a best practice stewardship code, could help investors in China accelerate improvements in their investment practices, in the best interests of their clients, beneficiaries, broader society and the economy.

RESTRAINING EXCESSIVE RISK-TAKING AND SUPPORTING THE SUSTAINABLE DEVELOPMENT OF THE REAL ECONOMY

The New AM Regulations signaled a clear intention to restrain excessive risk-taking in investment and guide the financial sector to support the development of the real economy.[53] They stressed that serving the real economy is the fundamental goal of the financial sector and there is a need to reduce the length and complexity of the investment chain, to stop financial institutions being distracted from their intended purpose and minimise the internal circulation of capital within the financial sector.[54]

A comprehensive regulatory framework, including a stewardship code, could help clarify the stewardship obligations of different players along the investment chain, including asset owners, asset managers and service suppliers, and require them to align investment with the long-term interests of end-investors. These interests depend on the sustainable growth of investee companies. By facilitating constructive engagement, such a regulatory framework could help stakeholders gradually restore trust and confidence along the investment chain and allocate patient capital to support the sustainable growth of the real economy.[55]

IMPROVING CORPORATE GOVERNANCE IN CHINA

Improving the quality of listed companies in China is an important government priority. The positive correlation between the involvement of institutional investors and improvements in corporate governance has been widely evidenced by empirical research.[56] Institutional investors have an important role to play to address both vertical

State Council Opinions on Further Improving the Quality of Listed Companies (2020)

"Establish a good communication mechanism between the board of directors and investors, and improve the channels and ways for institutional investors to participate in corporate governance."

[53] New AM Regulations. Follow up regulations and policies, such as Guiding Opinions on Boosting High Quality Development of Banking and Insurance Business, Interim Regulations on Insurance Asset Management Products, and Regulations of Wealth Management Subsidiaries to Commercial Banks, have all warned against shadow banking and channeling.
[54] New AM Regulations.
[55] Gond, J-P. (2017). How ESG engagement creates value: bringing the corporate perspective to the fore; O'Sullivan, N & Gond, J-P. (2016). *Engagement: unlocking the black box of value creation*.
[56] Rongli Yuan, Jason Zezhong Xiao, Hong Zou (2008), Mutual funds' ownership and firm performance: evidence from China, *The Journal of Banking & Finance*; May H, Jingjing Yang (2013) Fraud, market reaction, and role of institutional investors in Chinese listed firms, *26th Australasian Finance and Banking Conference 2013*, Michael Firth, Jin Gao, Jianghua Shen, Yuanyuan Zhang (2016), Institutional stock ownership and firm's cash dividend policies: evidence from China, The Journal of Banking &

and horizontal agency issues[57] that are common in the corporate governance of Chinese listed companies.

Nevertheless, it has been observed that many institutional investors lack the incentives and power to actively influence corporate governance.[58] One of the major constraints identified in the PRI's case studies is the lack of clear requirements or guidance regarding investor stewardship. The CSRC has established the Securities Investor Services Centre (CSISC) to set an example for Chinese investors to actively exercise investor rights and improve the corporate governance of listed companies. [59] A regulatory framework that explicitly requires investor stewardship to be aligned with clients' investment horizons, take into account ESG factors, and enable collective engagement could mobilise institutional investors across the market to better monitor and engage with investees. This could substantially change the dynamics of the corporate governance of investee companies, helping to check potential abuse of power by controlling shareholders and enhancing the accountability of corporate management.

CREATING AN ENABLING ENVIRONMENT FOR DELIEVERING REAL-WORLD SUSTAINABILITY OUTCOMES

In light of increasing expectations of investors directing capital to addressing ESG issues, investors also need an enabling environment to drive positive change. A stewardship code can, by clarifying investors' stewardship obligations, normalise and incentivise stewardship activities and reduce unjustified pushback from companies. By setting out key stewardship levers, such codes can guide investors to help support the green transition by using their influence, whether through investee/issuer engagement, voting, policy engagement or other stewardship tools. This can help investees work towards strategies aligned with China's carbon neutrality goal, as well as the transition and upgrading of the real economy.

In addition to a stewardship code, a taxonomy for sustainable activities could also help investors understand whether an economic activity is sustainable and allow them to assess and track progress of stewardship activities in driving positive outcomes. Mandatory and standardised corporate ESG disclosure rules could also provide investors with comparable information on corporate performance on ESG issues to better inform stewardship to drive positive real-world changes. Moreover, improving and updating voting infrastructure to streamline voting processes would further encourage institutional investors to increase their voting activity.

Finance; Amon Chizema, Wei Jiang, Jing-Ming Kuo and Xiaoqi Song (2020), Mutual funds, tunnelling and firm performance: evidence from China, Review of Quantitative Finance and Accounting.
[57] Jiang, F., Kim, K. A. (2020). Corporate Governance in China: A survey, *Review of Finance*, Volume 24, Issue 4.
[58] Ibid.
[59] China Securities Investor Services Center .

CLARIFYING BASIC ELEMENTS OF GOOD STEWARDSHIP

With stewardship practices becoming increasingly prevalent across the market, there is a need to distinguish between positive and negative investor influence on investee companies. This is even more important when investors have increasing influence in capital markets and the economy. Fragmented approaches to regulating stewardship might cause further confusion and raise the cost of compliance. To promote and guide investor stewardship, joint actions from financial regulators are needed to harmonise stewardship requirements for the entire investment community. This can help prevent regulatory arbitrage and provide detailed guidance for the whole spectrum of stewardship activities. Among other things, a stewardship code incorporating stewardship best practices and providing institutional investors with clear guidance to engage with investees and exercise legal rights in an effective, transparent and accountable manner could help provide the needed clarity.

ADDRESSING THE CHALLENGE OF COLLECTIVE ACTION

One of the major disincentives to investors pursuing stewardship practices is freeriding.[60] A stewardship code or similar regulations clarifying that all institutional investors should engage in stewardship and disclose their policies and practices accordingly could reduce this risk. It creates a general expectation that the costs of stewardship are widely distributed among investors, and the required accountability on stewardship activities would make it difficult for free riders to escape public scrutiny. In this way, stewardship codes can effectively reduce the incentives to free ride and instead support collaborative engagement. It is also important to facilitate or encourage the establishment of a platform supporting the coordination of collaborative engagement. Apart from that, clarifying legal uncertainties regarding potential impediments or deterrents to collaboration for stewardship purposes can help address some investors' concerns.[61]

ALIGNING WITH INTERNATIONAL BEST PRACTICES

Over more than a decade of development, stewardship has become a mainstream practice in many economies. Stewardship codes, such as those in the UK and Japan, have been regularly revised to incorporate evolving best practice to guide investors in discharging their stewardship obligations. A regulatory framework for effective stewardship should take account of both local characteristics and international best practices. This could help to enhance the quality of financial services in China, its competitiveness in the global market, and the ability of Chinese firms to attract long-term patient capital. Additionally, pension funds and insurance companies funding annuities, and the beneficiaries of those annuities, tend to have a long-term perspective. They have a strong interest in ensuring that investee companies are successful and sustainable over time and they therefore have a strong sensitivity to material ESG risks, including systemic market risks such as climate change.

---

[60] PRI, *A Practical Guide to Active Ownership in Listed Equity*, 19.
[61] PRI, *A Legal Framework for Impact*, 261.

ENHANCING OVERALL FINANCIAL MARKET STABILITY

One of the lessons of the 2008 financial crisis is that institutional investors should act as responsible shareholders of public companies to restrain excessive risk-taking and short-termism.[62] Encouraging long-term value creation as a key element of a responsible investment approach is an essential principle of a stewardship code. It encourages investors to consider wider ESG factors as a core component of their fiduciary duty. By so doing, investors are encouraged to promote high standards of corporate governance in investees, exercise better pricing of risk, and seek to mitigate systemic risks. In a broader context, seeking long-term value creation ultimately contributes to a more stable and resilient financial market. Institutional investors, albeit with different investment strategy and business models, also benefit from a stable financial market and sustainable economic growth.

[62] Kay, J (2021). *Kay Review of UK Equity Markets and Long-term Decision Making*.

PART III: MAPPING CHINA'S EXISTING REGULATIONS AGAINST CORE STEWARDSHIP PRINCIPLES

This section seeks to identify the gaps between China's existing regulations and the core stewardship principles identified in Section II. It explores what policy development might be needed to establish a stronger regulatory framework for effective stewardship, including matters that could be included in a comprehensive stewardship code.

Principle 1: Core stewardship responsibilities

Institutional investors should monitor and engage with investees and other stakeholders. They should also diligently, actively and responsibly exercise investor rights as part of their fiduciary responsibilities to their clients and beneficiaries.

This principle specifies institutional investors' core stewardship responsibilities. These responsibilities derive from institutional investors' fiduciary act of managing beneficiaries and clients' assets, which should also include the management of delegated investor rights connected to these assets. It expects investors to fulfil these responsibilities by, for example:

- diligently monitoring portfolio companies;
- seeking to build relationships with the companies in which they invest or intend to invest and with other stakeholders to enable constructive dialogue, also known as engagement; and
- exercising delegated investor rights such as the right to vote, and to file shareholder resolutions, etc. in the interests of their clients and beneficiaries.

There is a lack of clarity whether existing investor obligations in China could be construed to cover stewardship responsibilities. Although fiduciary duty is not a well-established concept in China, many of the principles that underpin fiduciary duties are familiar to Chinese investors, such as the duties of honesty, good faith, prudence and diligence.[63] Together, they create a set of investor duties and obligations that mirror the duties and obligations expected of investors in other jurisdictions. Chinese financial regulators have specified, in various regulations, that asset managers' responsibilities include filing litigation or taking other legal actions on behalf of their clients.[64] The New AM Regulations further provide that asset managers should discharge their duties of "active management" and should not shift this duty to someone else or invest in other investment products except for mutual funds.[65] These principles and concepts underpinning investor duties are very broad and vague. Further clarification is therefore needed on the exact scope of duties they could require,

[63] These principle-based duties apply to asset managers based on special laws or contractual-based entrustment arrangements. See: PRI, *A Legal Framework for Impact*.
[64] For example, Article 20, Securities Investment Fund Law; Article 14, Interim Measures for the Administration of Insurance Asset Management Products; Article 11, Measures for the Administration of Private Asset Management Business of Securities and Futures Operators.
[65] New AM Regulations, para 22.

and the extent to which they can be interpreted to include stewardship responsibilities in a similar vein to other jurisdictions.[66]

It is important to note that Chinese policy makers and investor associations have encouraged institutional investors to actively exercise their legal rights to monitor and engage with investees on various occasions, such as the Rules of Corporate Governance for Listed Companies (Corporate Governance Code)[67] and the Guidance on Fund Managers' Exercise of Voting Rights[68] issued by the AMAC. However, there is lack of clarity on whether it is part of institutional investors' duties to do so. Moreover, there is a lack of a unified approach to regulate how institutional investors should exercise delegated investor rights to influence investees. The CSRC, the securities regulator, and its affiliated investor association have published rules on proxy voting and proxy solicitation,[69] leaving the banking, insurance and pension sectors uncovered. Meanwhile, it is also necessary to extend the scope of regulatory oversight to stewardship activities beyond proxy voting, such as engagement.

Principle 2: Governance, resources, capacity and incentive alignment

Investors should ensure their governance, resources, incentives and capacities support stewardship that are aligned with the (generally long-term) time horizons and preferences of clients and beneficiaries of the capital they manage.

Effective stewardship relies on proper governance, resources, incentives and capacity. This principle therefore requires institutional investors to:

- establish governance structures and processes to enable oversight and accountability for effective stewardship within their organisations;
- devote sufficient resources to support effective stewardship;
- provide training to enhance the capacity of stewardship staff; and
- align incentives of stewardship activities with the (generally long-term) preferences of beneficiaries or clients.

Improving the internal governance of institutional investors has long been a priority for financial regulation in China. Because stewardship has not been clearly specified in any policy document, few of the existing measures on governance structure, resources, incentives and capacity are directly

[66] For example, in the US, the DoL and the SEC have clarified that the fiduciary act of managing beneficiary or clients' assets includes the management of voting rights as well as other shareholder rights connected to shares of stock. The management of those rights and shareholder engagement activities should be subject to fiduciary requirements. See: *Interpretive Bulletin 2016-01, 81 FR 95879 (Dec. 29, 2016); Proxy Voting by Investment Advisors No. IA-2106. See also the UK Stewardship Code, Principle 9-12; Japan Stewardship Code, principle 3, 4 and 5.*
[67] Article 78 encourages institutional investors to participate in corporate governance by exercising shareholder rights to vote, to make inquiries and to make suggestions. Article 79 urges institutional investors to play a positive role in corporate governance by participating in important decision making, recommending candidates for boards of directors and supervisors, and monitoring the work of boards of directors and supervisors. Article 80 encourages institutional investors to publicly disclose the goals, principles, voting strategies and effects of exercising shareholder rights.
[68] AMAC, Guidance on Fund Managers Exercising Voting Rights on behalf of Funds.
[69] CSRC, Interim Rules on Public Solicitation of Shareholder Rights

related to stewardship activities.[70]

Principle 3: ESG integration in stewardship
Investors should integrate investment and stewardship, including ESG issues

To fulfil responsibilities to beneficiaries and clients, investors should integrate investment and stewardship. They could, for example, use insights garnered from stewardship to enhance investment decision making, or use investment research and analysis to inform constructive engagement with investees.

Investors should incorporate ESG factors into their investment and stewardship processes because ESG issues, including systemic issues, can present risks or opportunities to companies and affect long-term performance.[71]

Although there are non-binding obligations on investors to integrate ESG factors into investment processes,[72] many high-level policies and self-regulatory guidelines in China do encourage investors to incorporate ESG factors in investment decision making.[73] However, there is limited awareness of the potential of investor stewardship to drive a transition towards sustainability goals at investee companies. To unlock this potential, policy makers need to encourage investors to integrate ESG factors into stewardship activities, such as monitoring and engaging with investees, as well as proxy voting.

Principle 4: Managing conflicts of interest
Investors should establish a policy and disclose their approach to managing conflicts of interest when it comes to their stewardship activities

This principle exists to ensure that investors exercise stewardship in the best interests of their beneficiaries and clients. Most stewardship codes require investors to disclose a clear policy setting out the actions they will take in the event that potential for a conflict between the interests of the investor and their clients or beneficiaries becomes apparent, and which provides guidance for investors to manage such conflicts.

[70] Taking as an example the Corporate Governance Code for Banking and Insurance Institutions, the code sets out requirements for financial institutions to improve corporate governance in terms of shareholder responsibilities, shareholder meetings, board structure and senior management. There is limited attention paid to establishing a governance structure that supports stewardship practices, which is crucial to enhancing the accountability of institutional investors to clients or beneficiaries.
[71] DWS, *Digging deeper into the ESG-corporate financial performance-relations,* analyses over 2000 academic studies on how ESG factors affect corporate financial performance, finding “an overwhelming share of positive results. See also Mercer, *Investing in A Time of Climate Change*.
[72] Although most Chinese investors are not under an express duty to consider ESG issues, laws and regulations can be interpreted to require investors to consider ESG issues if they are instrumental to protecting the interests of clients or beneficiaries. In general, Chinese laws and regulations provide flexibility for investors to pursue investment with sustainable impact. See PRI, *Legal Framework for Impact*, China Annex, 255-259.
[73] Guidelines on Establishing a Green Financial System; AMAC, Green Investment Guideline (Trial); CBIRC, Interim Measures for Regulatory Rating of Insurance Asset Management Companies.

While many Chinese regulations impose strict restrictions on related-party transactions to prevent potential conflicts of interests between investment managers, controlling shareholders and beneficiaries or clients,[74] regulatory oversight of potential conflicts of interest arising from stewardship activities is still limited. Voting, shareholder resolutions, and engagement might also influence the interests of clients and have not been fully covered by existing regulations.[75]

Principle 5: Alignment of stewardship responsibility along the investment chain

Investors should monitor and hold to account managers and/or service providers to ensure their activities are aligned with investors' investment and stewardship policies.

There has been an explosion in the number of financial market intermediaries, partly due to the trend of outsourcing corporate functions (including investment and stewardship) to specialists such as asset managers, financial consultants and proxy voting agencies. The proliferation of financial intermediaries and outsourcing practices could potentially create misalignment of incentives between end-investors and the agent. In this regard, an increasing number of stewardship codes in other markets have encouraged investors to monitor or hold to account managers and other service providers to ensure their stewardship responsibilities are fulfilled. Asset owners and asset managers are subject to different requirements, given their different positions in the investment value chain.

Table 6: Responsibilities of asset owners and asset managers to monitor implementation of stewardship policies along the investment chain

<table>
<tr><th colspan="2">Institutional investors</th><th>Alignment of stewardship responsibilities in the investment chain</th></tr>
<tr><td rowspan="2">Asset owners</td><td>Outsourced asset management</td><td>■ Clearly incorporate stewardship expectations in the process of selecting and appointing asset managers.
■ Monitor asset managers to ensure they exercise stewardship according to asset owners' stewardship policies or expectations.</td></tr>
<tr><td>In-house asset management</td><td rowspan="2">■ Monitor proxy advisors to ensure voting has been executed according to managers' proxy voting policies.
■ Monitor data and research providers to ensure delivered services meet their stewardship needs.</td></tr>
<tr><td colspan="2">Asset managers</td></tr>
</table>

[74] For example, Measures for the Administration of the Operation of Publicly Raised Securities Investment Funds, Measures for the Administration of Related-party Transactions of Insurance Companies, Measures for the Administration of Wealth Management Subsidiaries of Commercial Banks, Private asset management business of securities and futures management institutions and Measures for the Supervision of the Conduct of Majority Shareholders of Banking and Insurance Institutions (Trial)

[75] AMAC's Guidance on Fund Managers Exercising Voting Rights on behalf of Funds requires fund managers to manage conflicts of interests arising out of voting activities.

For asset owners, existing Chinese regulations set out high-level requirements for selecting, appointing and monitoring asset managers.[76] Detailed investment requirements are usually specified in investment mandates. On the one hand, there is sufficient flexibility for asset owners to include stewardship requirements in investment mandates. On the other hand, there is a lack of an explicit obligation for asset owners to monitor asset managers to ensure assets are managed in alignment with their stewardship strategies and policies.

For asset managers, the New AM Regulations have clearly provided that institutional investors should actively manage entrusted assets and should not delegate their responsibilities to other asset managers. Regulatory oversight should be extended to cover asset managers' responsibilities to monitor service providers, such as proxy advisors and data suppliers, as such market practices are emerging.

Principle 6: Collaborative engagement

Investors should consider conducting their stewardship activities collaboratively, where appropriate

Collaboration can be one of the most effective ways for institutional investors to conduct their stewardship activities. This is particularly the case when investors have common objectives to promote long-term value, such as seeking improvements in corporate governance or the management of sustainability issues at an investee company or across markets.

However, to facilitate collaborative engagement, it is necessary to address free-riding. It is also important for regulators to clarify potential regulatory issues with collaborative engagement. The UK code, for example, requires investors to disclose in their stewardship policy the circumstances in which they seek to collaborate with other investors, either formally or informally, and articulate the rationale for this collaboration. This enhances transparency and facilitates public scrutiny in collaborative engagement.

In China, limited regulatory attention has been paid thus far to collaborative engagement. The corporate governance code for Banking and Insurance Companies encourages communication between shareholders, but it does not provide clear guidance on how this communication or collaboration should be carried out and managed.[77]

Principle 7: Reporting and disclosure

Investors should disclose to their beneficiaries and clients their stewardship policies, actions taken to fulfil stewardship responsibilities, and outcomes achieved.

[76] Taking the National Social Security Fund (NSSF) as an example, Interim regulations for investment management of NSSF, provided that the performance of asset managers should meet the requirements of the NSSF Council and listed several situations where retained asset managers must be delisted from the management plan.
[77] CBIRC, the Corporate Governance Code for Banking and Insurance Institutions, Article 17.

It is part of institutional investors' obligations to communicate to beneficiaries and clients how they have discharged their stewardship responsibilities. The disclosure and reporting obligations may vary in terms of scope, frequency and format of disclosure/reporting. Most stewardship codes require investors to disclose stewardship policies, proxy voting and engagement activities (both individual and collective), management of conflicts of interest, integration of ESG issues in stewardship, and the monitoring of stewardship activities by service providers/asset managers.

In China, AMAC's proxy voting guidance requires fund management companies to report on proxy voting activities. To enhance transparency and accountability in stewardship activities, it is important to extend disclosure and reporting requirements to cover all types of institutional investors regarding core stewardship responsibilities set out in previous principles.

Table 5: Gaps between China's existing regulations and core stewardship principles

Core stewardship principle	Relevant rules in existing regulations			Alignment	Recommendations
	Banking - and insurance-related policies	Securities-related policies	Pension-related policies		
Principle 1. Clarifying investor stewardship responsibilities	Duty of honesty, good faith, prudence and safety[78]	Duty of honesty, good faith, prudence and diligence/ effectiveness[79]	Duty of honesty, good faith, prudence and diligence[80]	Partially aligned	Improve clarity
Principle 2. Governance, resource, capacity and incentives alignment	No relevant rules	No relevant rules	No relevant rules	Not aligned	New rules needed
Principle 3. Integrating ESG into stewardship	Green/ESG investment[81]	Green/ESG investment[82]	No relevant rules	Partially aligned	Improve clarity New rules needed for the pension sector

[78] Contractual and agency duties owed by insurers to policy holders arise out of special laws or contract-based entrustment arrangements. See Chapter 7 of Part I and Chapter 23 of Part III of the Civil Code. For further analysis of these duties, see PRI, *A Legal Framework for Impact*, paras 2.4.4-5. Detailed responsibilities are set out in, for example, CBIRC, Interim Measures for the Administration of Insurance Asset Management Products.
[79] Articles 25 to 30 of the Trust Law, and Clause 24, Section 2, Chapter 4, Part 2 of the Interpretation of the Trust Law, For further analysis of these duties, see PRI, *A Legal Framework for Impact*, para. 2.3.8. Details of responsibilities are also listed in, for example, Securities Investment Fund Law and CSRC, Measures for the Administration of Private Asset Management Business of Securities and Futures Operators.
[80] Contractual and agency duties owed by the trustees to fund sponsors arise out of the entrustment arrangements. See Chapter 7 of Part I of the Civil Code, and Chapter 23 of Part III of the Civil Code. For further analysis of these duties, see PRI, *A Legal Framework for Impact*.
[81] CBIRC, Interim Measures for Regulatory Rating of Insurance Asset Management Companies (additional credits will be allocated to institutions who engage in green or ESG investing).
[82] AMAC, Green Investment Guideline (Trial).

Principle 4. Managing conflicts of interest	No relevant rules	Managing conflicts of interests in proxy voting[83]	No relevant rules	Partially aligned	Expand coverage New rules needed for the insurance and pension sectors
Principle 5. Collaborative engagement	No relevant rules	No relevant rules	No relevant rules	Not aligned	New rules needed
Principle 6. Stewardship responsibility alignment in the Investment chain	Asset owners' duty to monitor asset managers[84]	No relevant rules	Asset owners' duty to monitor asset managers[85]	Partially aligned	Improve clarity New rules needed for asset managers
Principle 7. Reporting and disclosure of stewardship activities and outcomes	No relevant rules	Disclosure and reporting of proxy voting activities[86]	No relevant rules	Partially aligned	Expand coverage New rules needed for insurance and pension sectors

Alignment:

Partially aligned: not all sectors of the investment industry are subject to similar requirements to the corresponding core stewardship principle.

Not aligned: requirements of existing rules do not match the corresponding core stewardship principles

Recommendations

- *Improve clarity:* existing rules are very abstract and vague, but they are flexible enough to be construed to cover the requirements of corresponding core stewardship principles. Clarification is needed to explicitly establish such principles.
- *Expand coverage*: existing rules are limited in their scope to cover all necessary elements of corresponding core stewardship principles. The scope of these rules should be extended to cover these elements.
- *New rules needed*: new rules should be developed to establish corresponding core stewardship principles.

[83] AMAC, Guidance on Fund Managers Exercising Voting Rights on behalf of Funds.
[84] CBIRC, Regulations of the Use of Insurance Funds, Article 27 and 28.
[85] State Council Rules No 667, Rules for National Social Security Funds (NSSF), Article 12; Ministry of Finance, and Ministry of Labor and Social Security, Interim regulations for investment management of NSSF, Chapters 3 and Chapter 9; State Council, Regulations for Investment of Basic Pension Funds, Chapters 2 and 5.
[86] AMAC, Guidance on Fund Managers Exercising Voting Rights on Behalf of Funds.

PART IV: RECOMMENDATIONS

It is widely believed and well supported by empirical evidence that effective stewardship enables investors to engage in corporate governance of investee companies in a constructive way and help create long-term value for their beneficiaries, which is a core element of investor fiduciary duties. Stewardship is also a powerful way for investors to deliver real-world outcomes aligned with sustainability goals and national strategies, such as achieving carbon neutrality and supporting common prosperity. To establish a regulatory framework to promote and enable effective investor stewardship in China, we recommend the following measures:

- **Recommendation 1: Develop a stewardship code**
  A stewardship code is important to mobilise investors across the industry to take stewardship responsibilities and encourage good practice by providing clear guidance and requirements. To that end, the code needs to set out key elements of effective stewardship, including in relation to key stewardship obligations and tools, governance, consideration of ESG issues (particularly systemic issues), collective engagement, transparency of activities and outcomes, and management of conflicts of interest. The code should apply to asset owners, asset managers and service providers to align interests along the investment chain with long-term interests of beneficiaries and clients whose investment returns depend on the sustainable development of investee companies.

- **Recommendation 2: Improve the sustainable investment policy framework and stewardship infrastructure**
  To enable effective stewardship focused on advancing the sustainable growth of investee companies, it is crucial to create an enabling environment. This includes a sustainable investment policy framework and necessary stewardship infrastructure, for example: further improving the taxonomy of sustainable activities; mandating standardised corporate ESG disclosure to provide comparable and consistent ESG data; updating infrastructure to improve the interoperability of different jurisdictions' voting and reporting systems; and supporting the supply of public goods, such as research on systemic sustainability issues.

- **Recommendation 3: Adopt a phased approach towards effective implementation of the stewardship code, avoiding mechanical box-ticking compliance. (Table 7 identifies key elements of the implementation of a stewardship code)**
  Some flexibility is needed to accommodate regulatory priorities at various stages of development in China. At an initial stage, the primary goal of a stewardship code is to promote a culture of stewardship and to guide investors' stewardship practices to improve over time. Investors should be encouraged to sign up to the stewardship code, apply stewardship principles and guidance on a comply-or-explain basis, and regularly disclose and report their stewardship activities and outcomes. Annual assessment of stewardship reports by the supervising body will help investors develop a better understanding of stewardship expectations. At a later stage, when investors are more experienced in integrating stewardship into their investment strategies and approaches, it may be worth considering introducing more stringent oversight for implementation and making stewardship responsibilities mandatory.

- **Recommendation 4: Ensure a joined-up approach from financial regulators to create a common language for stewardship.**
  Stewardship-related regulations have been unevenly developed among banking and insurance regulators, securities regulators and pension regulators. If stewardship expectations or requirements vary for different types of asset manager and asset owner, this can create incentives for regulatory arbitrage, cause unnecessary confusion and raise the costs of compliance. The New AM Regulation sets a good example of standardising the responsibilities and duties of asset managers. The introduction of a stewardship code and its implementation should also be coordinated among all relevant regulatory authorities or industry bodies.

- **Recommendation 5: Encourage investors to leverage collaborative engagement to maximise the influence of minority investors.**
  Collaborative engagement is an effective tool for institutional investors to influence investee companies in the face of controlling shareholders, which are common in many Chinese companies. In addition to a stewardship code that specifically encourages participation in collaborative engagement, it is important for regulators to clarify legal uncertainties regarding potential impediments or deterrents to collaborative engagement, particularly for addressing systemic sustainability issues. Encouraging the establishment of a local platform to coordinate collaborative engagement, focused on ESG issues (particularly systemic ones) that are material to the sustainable growth of Chinese companies, would substantially enhance the effectiveness of investor stewardship in China.

Table 7: Policy design and Implementation of a stewardship code[87]

Who establishes a stewardship code?
Financial regulators or industry bodies may establish stewardship codes. ■ Examples of stewardship codes issued by regulators: the UK Stewardship Code (2020); India's Stewardship Code For All Mutual Funds and AIFs (2019). Examples of stewardship codes issued by industry bodies: Australian asset owner stewardship code (2018)
Do all elements of stewardship codes need to be complied with?
■ Most stewardship codes adopt a 'comply or explain' approach, where signatories can diverge from the requirements if they explain the reasons for doing so. ■ The UK Stewardship Code entails an apply-and-explain approach which requires signatories to report on all principles and reporting expectations. In cases where there is a strong reason why a reporting expectation does not apply, applicants should explain this reason.
What are the implementation mechanisms?

■ Most codes are voluntary for investors to sign up to,[88] although they are increasingly referred to in legislation. For example, the India SEBI Code is mandatory for all asset managers.
■ Voluntary codes typical include the following elements:
  ■ Institutional investors are encouraged to sign up to the codes (creating a market norm where large investors support it).
  ■ A public register is maintained of code signatories, and signatory investors are also expected to publicise the code on their websites.
  ■ Signatory investors are expected to report on how they have implemented the code, providing data as well as case studies to illustrate the organisation's approach. Some codes require the signatory investor's chairperson, CEO or CIO to sign off on the accuracy of this report.
  ■ A formal review is conducted of how the code has been implemented. For example, under the UK code, the Financial Reporting Council (FRC) assesses the organisation's report and, if it meets FRC's reporting expectations, the organisation is listed as a signatory to the code. Once listed, organisations must annually report to remain a signatory.
  ■ Practical guides are developed to support implementation. For example, the Southern Africa Institute of Directors developed disclosure guidance. The FRC in the UK published a review of early reporting to help signatories meet reporting requirements.

[87] PRI and World Bank Group, *A Toolkit for Sustainable Investment Policy and Regulation*.
[88] Once investors adopt the code, they are required to follow requirements such as 'comply or explain'.

CREDITS

AUTHORS:

Junru Liu, PRI

Daniel Wiseman, PRI

CONTRIBUTORS:

Margarita Pirovska, PRI

Emmet Mcnamee, PRI

Ben Pincombe, PRI

Tom Barron, PRI (former)

Colleen Orr, PRI

Nan Luo, PRI

Aiwen Zhou, PRI

James Robertson, PRI

We would like to thank participants of case studies and reviewers for their time and contributions to this report, in particular:

CASE STUDY PARTICIPANTS:

BlackRock — BlackRock Investment Stewardship

BPEA — Zongzhong Tang

ChinaAMC — Miranda Zhao

E Fund — Wilson Wei, Monte Mu

EOS at Federated Hermes — Hannah Shoesmith, Yu-Ting Fu

Fidelity International — Flora Wong, Jingmin Hu

Harvest Investment Fund — Xiaoyan (Catherine) Han, Xiangjie Sun

Manulife Investment Management — Eric Nietsch, Yijin Guo

Southern Asset Management — Sisi Li, Shuangyang Chen, Wanyi Zhang, Zheng Tang

EXTERNAL REVIEWERS:

Kan Xiao, Head of International Affairs Team, IAMAC

Shuwei Tang, Partner, Ziding Proxy

Wei Kong, Partner, Zhong Lun Law Firm LLP

The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

PRI Principles for Responsible Investment

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UN environment programme | finance initiative

United Nations Global Compact

The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

More information: www.unglobalcompact.org

United Nations Global Compact