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# Can BlackRock Save the Planet? The Institutional Investors' Role in Stakeholder Capitalism

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*It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.*

Adam Smith, *Wealth of Nations*

*Table of Contents*



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## I. Introduction

The debate concerning the purpose of major corporations is becoming increasingly fierce. A major turning point in this debate came without doubt following the publication of the now famous "Statement" of the Business Roundtable in August 2019.[1] This Statement called—at least within its stated aims—for a radical change of course, moving beyond the notion that views a company exclusively as a vehicle for profit maximization (according to Milton Friedman's theory of shareholder value)[2] and recognizing that corporations must pursue broader goals, in the interests of other stakeholders and society as a whole.

However, responses to this position set out by the Business Roundtable have been largely skeptical. There is a widespread conviction that the BRT Statement amounted to little more than a vague declaration of intent, without any tangible implications.[3] In addition, the initiative taken by the Business Roundtable has been viewed by many as an attempt by the major US corporations to avoid the enactment of legislation feared by managers that has been proposed by some of the former candidates in the 2020 US presidential elections[4]—who, indeed, remain skeptical about the BRT Statement[5]—and, allegedly, to prevent populist attacks against businesses and the formation of anti-business views in this area.[6]

The widespread skepticism as to the real intentions of the 181 CEOs who signed on to the initiative promoted by the Business Roundtable appears to have been borne out by the facts. Analyses carried out by Aneesh Raghunandan and Shiva Rajgopal demonstrated that the companies whose CEOs endorsed the BRT Statement have not yet acted on the recommendations made by their leaders and in fact have been less virtuous on the sustainability front than corporations that did not back the BRT Statement.[7] For example, over the 2014–2018 period, the Environmental Protection Agency and the Occupational Safety and Health Administration recorded a higher number of environmental protection and occupational health and safety violations by companies whose CEOs

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[1] Press Release, Business Roundtable, Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans' (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans [hereinafter BRT Statement].

[2] Milton Friedman, *A Friedman doctrine-- The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES (Sept. 13, 1970), https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html.

[3] *See, e.g.*, Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91 (2020).

[4] Editorial Board, *The 'Stakeholder' CEOs*, WALL ST. J. (Aug. 19, 2019), https://www.wsj.com/articles/the-stakeholder-ceos-11566248641.

[5] Elizabeth Warren, *Business Roundtable declaration 'was just an empty publicity stunt'*, FAST COMPANY (Sept. 29, 2020), https://www.fastcompany.com/90557370/elizabeth-warren-business-roundtable-declaration-was-just-an-empty-publicity-stunt ("If the CEOs of the nation's largest corporations truly share my commitment to a stronger economy for workers, communities, and consumers, they should fully commit to the principles they claim to hold, put them into action, and publicly report on their progress.").

[6] *See* Stephen M. Bainbridge, *Corporate Purpose in a Populist Era* (UCLA Sch. L., L. & Econ. Rsch. Paper No. 18-09, 2019), https://ssrn.com/abstract=3237107.

[7] Aneesh Raghunandan & Shiva Rajgopal, *Do the Socially Responsible Walk the Talk?* (Dec. 21, 2020) (unpublished manuscript), https://ssrn.com/abstract=3609056.

signed the BRT Statement.[8] This was in addition to an increase in purchases of own shares (which is generally indicative of a short-term outlook), as well as a lower correlation between managers' pay and increases in the share value.[9]

However, the importance of these findings should not be overstated if the BRT Statement is regarded as a commitment by signatories to improve their own sustainability policies. Within this perspective, the fact that numerous investors in the United States have presented shareholder proposals in the run-up to the last annual general meeting (AGM) season with the aim of encouraging actual compliance with the BRT Statement by signatory companies is undoubtedly significant. Although non-binding proposals of this type made by small shareholders do not generally attract support from a sufficiently large group of shareholders, they might induce companies—also in view of the media attention triggered by them[10]—to act in a manner compatible with the principles set out in the BRT Statement.[11]

Nonetheless, doubts still remain as to the actual implications of the Business Roundtable initiative as well as the content of the debate triggered by it into the purpose of corporations.

First of all, as much as the terms of the question are often summarized with reference to the dichotomy between a model centered on shareholders and one that is open to the different categories of stakeholders, it must not be forgotten that this approach leads to hyper-simplification, which is at least in part misleading.[12] This is clearly demonstrated by the fact that, in his famous article setting out the general terms of the shareholder value theory, Milton Friedman himself observed that initiatives that are currently regarded as an expression of stakeholder-oriented conduct are in actual fact entirely in keeping with the objective of maximizing shareholder profits.[13] For example, according to Friedman:

[I]t may well be in the long-run interest of a corporation that is a major employer in a small community to devote resources to providing amenities to that community or to improving its

[8] *Id.* at 19.

[9] Aneesh Raghunandan & Shiva Rajgopal, *Is There Real Virtue Behind the Business Roundtable's Signaling?*, WALL ST. J. (Dec. 2, 2019), https://www.wsj.com/articles/is-there-real-virtue-behind-the-business-roundtables-signaling-11575330172.

[10] For example, the initiative promoted in relation to BlackRock by As You Sow, a Californian nonprofit association specializing in shareholder advocacy, received particular attention. The shareholder proposal presented asked BlackRock to illustrate the way in which it intended to adapt its strategies to the principles set out in the Business Roundtable Statement. *See* Paul Verney, *Blackrock seeks to dodge proposal on Business Roundtable commitments*, RESPONSIBLE INV. (Jan. 23, 2020), https://www.responsible-investor.com/articles/blackrock-seeks-to-dodge-proposal-on-business-roundtable-commitments.

[11] Patrick Temple-West, *Business Roundtable members face challenge over commitments*, FIN. TIMES (Feb. 27, 2020), https://www.ft.com/content/04e5da48-582c-11ea-abe5-8e03987b7b20.

[12] John Gerard Ruggie, *Corporate Purpose in Play: The Role of ESG Investing* (Harvard Kennedy Sch. Faculty Rsch. Working Paper Series RWP19-034, 2019), https://ssrn.com/abstract=3483205.

[13] Friedman, *supra* note 2.

government. That may make it easier to attract desirable employees, it may reduce the wage bill or lessen losses from pilferage and sabotage or have other worthwhile effects.[14]

Secondly, the dichotomy between shareholders and stakeholders on which the current debate into the future of corporations is based appears to be inadequate as it is difficult to deny that (current and potential) shareholders still play a central role, even under the stakeholder approach, as they are able to exert a decisive influence on the way in which directors act.[15]

If the shareholders afford priority to short-term objectives, it is unlikely that it will be possible to transform the aspirations listed in the BRT Statement into any tangible interventions. More specifically, if shareholder objectives are not aligned with those of managers, it is unlikely that managers could actually be incentivized to pursue sustainability policies that are liable to have a negative impact on profits, especially over the short term.[16]

Whilst they may help to relaunch the debate and draw attention to environmental, social, and governance (ESG) issues, "commitments" that are made by managers alone would not appear to be sufficient. This is because there can only be an effective change in course and the principles mentioned in the BRT Statement can only be actually applied if to do so would also be in line with the interests of the shareholders, including in particular the major shareholders of large corporations.[17]

On this point the former Chief Justice of the Delaware Supreme Court, Leo Strine, has pointed out that within a context in which ownership of listed companies is becoming increasingly concentrated owing to the unstoppable growth in institutional investors, those investors must play a decisive role in bringing about a shift towards corporate sustainability.[18] According to Strine, in order to achieve this it would be necessary to step up the obligation on institutional investors to promote sustainable development objectives and, adopting the perspective of end investors, to consider the importance of having companies that are capable of creating jobs and acting in an ethically responsible manner towards consumers and the environment.

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[14] *Id.*; *see also* Alex Edmans, *What Stakeholder Capitalism Can Learn from Milton Friedman*, PROMARKET (Sept. 10, 2020), https://promarket.org/2020/09/10/what-stakeholder-capitalism-can-learn-from-milton-friedman/.

[15] Jesse Fried, *Shareholders always come first and that's a good thing*, FIN. TIMES (Oct. 7, 2019), https://www.ft.com/content/fff170a0-e5e0-11e9-b8e0-026e07cbe5b4 ("CEOs can take other stakeholders' interests into account. But only as long as investors don't object."); *see also* Luca Enriques, *Missing in Today's Shareholder Value Maximization Credo: The Shareholders*, PROMARKET (Sept. 22, 2020), https://promarket.org/2020/09/22/milton-friedman-value-maximization-credo-is-missing-the-shareholders/.

[16] Jonathan Ford, *The Business Roundtable's makeover does not go far enough*, FIN. TIMES (Sept. 22, 2019), https://www.ft.com/content/0739278e-dba2-11e9-8f9b-77216ebe1f17 ("Driven by survival instinct, fund managers have no motivation to invest on fundamentals, even if they might want to. Instead they have powerful incentives to follow short-term trends and bubbles rather than finding the most profitable outlets for the money trusted to them.").

[17] *See, e.g.*, Ruggie, *supra* note 12, at 3 (noting that the move toward the more social entity conception of the public corporation implied by the BRT Statement will be reinforced by the remarkable rise of ESG investors who take into account a company's environmental, social, and governance policies in making investment decisions).

[18] *See* Leo E. Strine, Jr., *Toward Fair and Sustainable Capitalism* 8–14 (Univ. of Pa L. Sch. Inst. for L. & Econ. Rsch. Paper No. 19-39, 2019), https://ssrn.com/abstract=3461924.

In the wake of this and other similar proposals, institutional investors are ever more considered to be a force capable of playing a major role in favoring the shift towards "stakeholders' capitalism," according to which "corporate leaders should give weight not only to the interests of shareholders but also to those of all other corporate constituencies (including employees, customers, suppliers, and the environment)."[19] Relatedly, the calls for institutional investors to place greater focus on ensuring that their investments are sustainable are becoming steadily more pressing, also in view of the increasing demands for such outcomes by end clients.[20]

## II. The Sustainability-Centered Tectonic Shift in the Asset Management Sector: Larry Fink's 2020 and 2021 Letters to CEOs

The developments described above help to explain the particular attention attracted at the international level by the annual letters written in 2020 and 2021 by Larry Fink, CEO of BlackRock (the largest asset manager in the world[21]) to the CEOs of investee companies.[22] In actual fact, since BlackRock invests in thousands of companies internationally, and in many of them is one of the most important shareholders,[23] for some years now Larry Fink's annual letter has been a particularly anticipated event for the financial markets and observers. In fact, on a number of occasions the ways forward indicated by the BlackRock CEO have paved the way for future trends, as occurred in relation to the debate on the purpose of the corporation. The 2018 annual letter (which was eloquently entitled 'A Sense of Purpose') touched on many of the issues that were subsequently addressed in the BRT Statement. In that letter, Larry Fink had asserted in particular that "[t]o prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate."[24]

The 2020 annual letter written by Larry Fink (along with the letter sent at the same time by top managers at BlackRock to their own clients) also appears to be capable of significantly influencing developments in the asset management sector.[25] The importance of systemic risks (such as the

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[19] Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance: Presentation Slides* (Nov. 9, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3581299.

[20] *See* Attracta Mooney, *Biggest asset managers attacked over role in climate change*, FIN. TIMES (Jan. 13, 2020), https://www.ft.com/content/8aade207-09bc-41a7-9f0a-24417882f1bc; Laura Tyson & Larry Mendonca, *Making Stakeholder Capitalism a Reality*, PROJECT SYNDICATE (Jan. 6, 2020), https://www.project-syndicate.org/commentary/making-stakeholder-capitalism-reality-by-laura-tyson-and-lenny-mendonca-2020-01.

[21] Michael Mackenzie, *BlackRock assets surge to record $8.68tn*, FIN. TIMES (Jan. 14, 2021), https://www.ft.com/content/53b35fee-a8c3-4a18-85ef-d7f2527d0ba0.

[22] Larry Fink, *Larry Fink's 2020 Letter to CEOs: A Fundamental Reshaping of Finance* (2020), https://www.blackrock.com/corporate/investor-relations/2020-larry-fink-ceo-letter [hereinafter *Fink's 2020 Letter to CEOs*].

[23] *See generally* Jan Fichtner & Eelke M. Heemskerk, *The New Permanent Universal Owners: Index Funds, Patient Capital, and the Distinction Between Feeble and Forceful Stewardship,* 49 ECON. & SOC'Y 493, 503 (2020).

[24] *See* Larry Fink, *Larry Fink's 2018 Letter to CEOs: A Sense of Purpose* (2018), https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter.

[25] On the relevance of Fink's annual letter for the asset management sector, see Andrea Pawliczek, A. Nicole Skinner & Laura A. Wellman, *A New Take on Voice: The Influence of BlackRock's "Dear CEO" Letters* 4 (Jan. 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3763042 (finding that portfolio firms' disclosures reflect

climate risk) for investment choices has been considered for some time by scholars,[26] sectoral operators[27]—and, in Europe, by the European Commission itself.[28] However, this was the first time that a leading institutional investor such as BlackRock directed attention in such a decisive way to the crucial significance of the climate risk, going so far as to consider it a factor that was capable of precipitating (as mentioned by Larry Fink himself in the introduction to his 2020 letter) "a fundamental reshaping of finance."[29]

In addition, compared to the letters sent in previous years, the 2020 annual letters sent by BlackRock in January 2020 appear to have taken things to the next level as they not only report (as in the past) various general trends, but also set out the precise initiatives that BlackRock intends to pursue when making its investment choices and when exercising stewardship over the listed companies in which BlackRock holds shares.[30]

Turning to some of the more detailed observations concerning the content of the 2020 letter sent by Larry Fink to CEOs of investee companies, there is no doubt that the strongest message contained in it is the clear reference to the central importance of the climate risk as "a defining factor in companies' long-term prospects," which is liable to have a "significant and lasting impact on economic growth and prosperity."[31] Consequently, in order to satisfy the interests of end

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topics similar to those discussed in the letters during the post-letter period and, namely, "8-Ks filed 30 days after the letter by firms with significant BlackRock ownership exhibit relatively more similar language (to that contained in the BlackRock letter) relative to firms with less BlackRock ownership").

[26] *See* Jeffrey N. Gordon, *Addressing Economic Insecurity: Why Social Insurance Is Better Than Corporate Governance Reform*, CLS BLUE SKY BLOG (Aug. 21, 2019), https://clsbluesky.law.columbia.edu/2019/08/21/addressing-economic-insecurity-why-social-insurance-is-better-than-corporate-governance-reform/; Jeffrey N. Gordon, *Systematic Stewardship* 17–33 (Eur. Corp. Governance Inst., L. Working Paper No. 566/2021, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3782814; Madison Condon, *Externalities and the Common Owner*, 95 WASH. L. REV. 1 (2020); John C. Coffee, *The Future of Disclosure: ESG, Common Ownership, and Systematic Risk* 22–35 (Eur. Corp. Governance Inst., L. Working Paper No. 541/2020, 2020), https://ssrn.com/abstract=3678197.

[27] *See generally* Veena Ramani, *Addressing Climate as a Systemic Risk: A Call to Action for Financial Regulators*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (June 28, 2020), https://corpgov.law.harvard.edu/2020/06/28/addressing-climate-as-a-systemic-risk-a-call-to-action-for-financial-regulators/.

[28] *See* EUR. COMM'N, *Communication from the Commission to the European Parliament, the European Council, the European Central Bank, the Economic and Social Committee and the Committee of the Regions: Action Plan: Financing Sustainable Growth* 3 (Mar. 8, 2018) ("Including environmental and social goals in financial decision-making aims to limit the financial impact of environmental and social risks.").

[29] *Fink's 2020 Letter to CEOs*, *supra* note 22.

[30] For an overview of the "CEO letters" sent by Larry Fink over the last few years, see Jackie Cook, *Larry Fink's Words Versus Actions on ESG in 2021,* MORNINGSTAR (Feb. 8, 2021), https://www.morningstar.com/articles/1021762/larry-finks-words-versus-actions-on-esg-in-2021; Bernard S. Sharfman, *The Conflict between Blackrock's Shareholder Activism and ERISA's Fiduciary Duties*, CASE WESTERN L. REV. (forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3691957.

[31] *Fink's 2020 Letter to CEOs*, *supra* note 22 (describing the central importance of climate change-related risks by raising the following questions: "[w]hat will happen to the 30-year mortgage – a key building block of finance – if lenders can't estimate the impact of climate risk over such a long timeline, and if there is no viable market for flood or fire insurance in impacted areas? What happens to inflation, and in turn interest rates, if the cost of food climbs from drought and flooding? How can we model economic growth if emerging markets see their productivity decline due to extreme heat and other climate impacts?").

investors in the best way possible, it is necessary to ensure that "sustainability- and climate-integrated portfolios can provide better risk-adjusted returns to investors," given that "with the impact of sustainability on investment returns increasing . . . sustainable investing is the strongest foundation for client portfolios going forward."[32]

Whilst noting that initiatives at government level will be essential in order to manage the climate risk and to promote the transition to a low-carbon economy, Larry Fink stresses that corporations too can play an important role in this regard. In particular, each company should not only provide more complete and clear information in relation to climate issues but also illustrate "how [it] serves its full set of stakeholders, such as the diversity of its workforce, the sustainability of its supply chain, or how well it protects its customers' data."[33]

With that aim in mind, given the absence of any uniformly accepted international sustainability reporting standard, BlackRock states its preference for the reporting criteria drawn up by the Sustainability Accounting Standards Board (SASB) and—in order to assess and report on climate-related risks along with the associated governance problems that are essential in order to manage them—the guidelines of the Task Force on Climate-related Financial Disclosures (TCFD), which was established in 2015 by the Financial Stability Board.

Considering the influence that BlackRock is capable of wielding over numerous listed companies, the endorsement of the reporting standards mentioned above may help to establish them as reference standards.[34] This is especially due to the warning issued by Larry Fink to directors of investee companies, in stating that—in line with how it has acted in past years—BlackRock will increasingly vote at AGMs against any directors who do not adhere to those standards when companies "are not making sufficient progress on sustainability-related disclosures and the business practices and plans underlying them."[35]

However, Larry Fink stresses that disclosure must not be an end in itself but rather:

[A] means to achieving a more sustainable and inclusive capitalism. Companies must be deliberate and committed to embracing purpose and serving all stakeholders . . . customers, employees, and the communities . . . . In doing so, your company will enjoy greater long-term prosperity, as will investors, workers, and society as a whole.[36]

As mentioned above, the letter sent by Larry Fink to managers of investee companies must be read alongside the other letter sent by BlackRock's Global Executive Committee to its own clients.[37]

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[32] *Id.*
[33] *Id.*
[34] *See* David M. Silk, Sabastian V. Niles & Carmen X. W. Lu, *BlackRock Nudges Companies Toward a Common Standard (SASB + TCFD)*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 18, 2020), https://corpgov.law.harvard.edu/2020/01/18/blackrock-nudges-companies-toward-a-common-standard-sasb-tcfd/.
[35] *Fink's 2020 Letter to CEOs*, *supra* note 22 (mentioning that, in 2019, "BlackRock voted against or withheld votes from 4,800 directors at 2,700 different companies").
[36] *Id.*
[37] BlackRock's Global Executive Committee, *BlackRock's 2020 Letter to Clients: Sustainability as BlackRock's New Standard for Investing* (2020), https://www.blackrock.com/us/individual/blackrock-client-letter [hereinafter BlackRock's Global Executive Committee's 2020 Client Letter].

In this letter, it sets out in greater detail the action that BlackRock intends to take in order to enhance the sustainability of its own investment strategies and stewardship action.

First of all, it clarifies that sustainability considerations will be incorporated into both active and passive investment strategies. With regards to the latter, it planned to change the indexing criteria with part of the index funds using "[ESG-]optimized index exposures in place of traditional market cap-weighted index exposures."[38] On the active management side, it planned to incorporate ESG factors more stringently, "meaning that, at the portfolio level, our portfolio managers will be accountable for appropriately managing exposure to ESG risks and documenting how those considerations have affected investment decisions."[39] This implies—and it is here that the most radical change in approach is apparent—that BlackRock "considers ESG risk with the same rigor that it analyzes traditional measures such as credit and liquidity risk."[40]

The central importance ascribed to ESG has a direct impact on the selection of companies in which BlackRock invests on behalf of its own clients. In fact, it is mentioned in the letter sent to them that "[i]n heightening our scrutiny on ESG issues, we are continuously evaluating the risk-return profile and negative externalities posed by specific sectors as we seek to minimize risk and maximize long-term return for our clients."[41] As a result, BlackRock does not have any exposure to bonds or equities of companies operating in certain sectors with a high-ESG risk, such as controversial producers of weapons systems, and intends to reduce further its investments in companies with a high-ESG risk profile. Within this perspective, BlackRock also declares its intention to limit investment in companies that produce thermal coal, and with that end in mind intends to divest listed securities (bonds and equities) of companies that generate more than 25% of their revenues from the production of thermal coal from "active" portfolios within the first six months of 2020.[42] At the same time, again as far as active management is concerned, BlackRock intends to develop further so-called "impact investing" strategies involving the creation of portfolios that aim to generate a return by picking companies that are selected due to their positive, measurable impact in sustainability terms, and in particular the benefits created by the social context within which they operate.[43]

Attention to ESG factors is also reflected in the configuration of the financial products offered by BlackRock which, in line with the strategic guidelines illustrated, intends to increase the range of passive funds—i.e. indexed funds and exchange-traded funds (ETFs)—that are compliant with the

[38] *Id.*
[39] *Id.*
[40] *Id.* (illustrating that BlackRock will integrate these measurements into Aladdin, BlackRock's risk management and investment technology platform). This can have significant implications, and in particular favor the dissemination of investment strategies that take account of the ESG factors promoted by BlackRock since many competitor asset managers and a large number of listed companies use the analyses prepared by Aladdin when making their own investment decisions. *See* Richard Henderson & Owen Walker, *BlackRock's black box: the technology hub of modern finance*, FIN. TIMES (Feb. 24, 2020), https://www.ft.com/content/5ba6f40e-4e4d-11ea-95a0-43d18ec715f5 (reporting that Aladdin "acts as the central nervous system for many of the largest players in the investment management industry").
[41] BlackRock's Global Executive Committee's 2020 Client Letter, *supra* note 37.
[42] *Id.*
[43] *Id.*

highest ESG standards, including through the creation of "sustainable" versions of the most successful ETFs. Within this perspective, it is certainly important to note BlackRock's intention not only to develop its own indices that comply with high ESG standards but also to cooperate with the providers of the reference indices for some of BlackRock's indexed funds with the aim of encouraging the removal from indices of companies with a high ESG risk, such as producers of thermal coal.[44]

With a view to protecting above all investors that invest in passive funds, BlackRock has also stated its intention to step up stewardship initiatives in relation to ESG issues. In fact, investors in indexed funds are by definition long-term investors given that it is essentially impossible for them to sell shares in the companies included in the relevant index. To that effect, according to the letter sent to its clients, BlackRock is committed to increasing the number of meetings with listed companies and will vote against any proposals that do not comply with ESG standards deemed to be adequate.[45] In addition, always in line with the commitments of BlackRock's Global Executive Committee illustrated in the 2020 letter to its own clients,[46] Blackrock has significantly increased the level of transparency in relation to its own stewardship activities. In particular, from the first quarter of 2020, it started publishing a statement concerning the choices made when exercising voting rights on a quarterly rather than an annual basis.[47] In addition, departing from the practices prevailing amongst the other most important institutional investors, on key high-profile votes, BlackRock has disclosed its vote promptly, along with an explanation of its decisions, and has enhanced the disclosure of its company engagements by including in its stewardship annual report the topics it discussed during each engagement with a company."[48]

Larry Fink and BlackRock's Global Executive Committee have reiterated and further detailed their strategies and expectations in the 2021 BlackRock letters to investee companies and clients, where climate risk remains the key issue.[49] Namely, in his annual letter to the CEOs of investee companies,[50] Larry Fink highlights that the tectonic shift mentioned in his previous annual letter is accelerating due to the shift in investor behavior, as demonstrated by the fact that "[f]rom January through November 2020, investors in mutual funds and ETFs invested $288 billion globally in sustainable assets, a 96% increase over the whole of 2019."[51] In light of such a change in investors' preferences and expectations, Larry Fink asks investee companies to disclose a "plan for how their business model will be compatible with a net zero economy"—that is, "one that emits no more carbon dioxide than it removes from the atmosphere by 2050, the scientifically-

[44] *Id.*
[45] *Id.*
[46] *Id.*
[47] BlackRock's 2020 quarterly stewardship reports are available at https://www.blackrock.com/corporate/about-us/investment-stewardship#about-us.
[48] *See e.g.,* BLACKROCK, INVESTMENT STEWARDSHIP GLOBAL ENGAGEMENT SUMMARY REPORT: Q1-Q4 2020 (2020), https://www.blackrock.com/corporate/literature/press-release/blk-engagement-summary-report-2020.pdf.
[49] *See* Cook, *supra* note 30.
[50] Larry Fink, *Larry Fink's 2021 Letter to CEOs* (2021), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter [hereinafter *Fink's 2021 Letter to CEOs*].
[51] *Id.*

established threshold necessary to keep global warming well below 2ºC."[52] To this end, like in 2020, investee companies are encouraged to use the frameworks of the TCFD and the SASB.[53] Moreover, Larry Fink draws attention to questions of racial justice, economic inequality, and community engagement, and expects that companies disclose "long-term plans to improve diversity, equity, and inclusion" in their sustainability reports.[54]

In line with the statements by Larry Fink, the Global Executive Committee of BlackRock in its 2021 annual letter to clients,[55] reiterates the commitment to make sustainability a new standard for investing. Namely, BlackRock's key actions for 2021 include "[i]ncorporating the impacts of climate change into our capital market assumptions, the cornerstone for portfolio construction at BlackRock," "[i]mplementing a 'heightened-scrutiny model' in our active portfolios as a framework for managing securities that pose significant climate risk," and "[l]aunching investment products with explicit temperature alignment goals, including products aligned to a net zero pathway."[56] In addition, as far as stewardship activities for 2021 are concerned, BlackRock intends to use "investment stewardship to ensure the companies our clients invest in are mitigating climate risk and considering the opportunities presented by the net zero transition" and increase "the role of votes on shareholder proposals in our stewardship efforts around sustainability."[57]

## III. Final Clients' Preferences as a Key Driver of the Incorporation of ESG Factors into Asset Managers' Investment and Stewardship Policies

In light of the above, with a view to setting out some more general considerations on the role that (leading) institutional investors can actually play in pushing the transition towards stakeholder capitalism, it is essential to consider the reasons that led BlackRock, the largest asset manager in the world, to adopt such a groundbreaking position, and above all what the effective ramifications of this initiative might be.

With regard to the former aspect, as some have argued, BlackRock's decision to focus its 2020 and 2021 annual letters on the importance of climate change (along with the previous decision to

[52] *Id.*; *see also* BLACKROCK, CLIMATE RISK AND THE TRANSITION TO A LOW-CARBON ECONOMY 3 (2021), https://www.blackrock.com/corporate/literature/publication/blk-commentary-climate-risk-and-energy-transition.pdf (setting out BlackRock's expectations in greater detail).

[53] *Fink's 2021 Letter to CEOs*, *supra* note 50; *see also* BLACKROCK, SUSTAINABILITY REPORTING: CONVERGENCE TO ACCELERATE PROGRESS (2020), https://www.blackrock.com/corporate/literature/publication/blk-commentary-sustainability-reporting-convergence.pdf.

[54] *Fink's 2021 Letter to CEOs*, *supra* note 50.

[55] BlackRock's Global Executive Committee, *BlackRock's 2021 Letter to Clients: Net Zero: A Fiduciary Approach* (2021), https://www.blackrock.com/corporate/investor-relations/blackrock-client-letter [hereinafter BlackRock's Global Executive Committee's 2021 Client Letter].

[56] *Id.*

[57] *Id.* ("[I]n the second half of 2020, we supported 54% of all environmental and social proposals, having assessed that they were aligned with long-term value."). *But see* Jackie Cook & Tom Lauricella, *How Big Fund Families Voted on Climate Change: 2020 Edition,* MORNINGSTAR (Sept. 28, 2020), https://www.morningstar.com/articles/1002749/how-big-fund-families-voted-on-climate-change-2020-edition ("Support for resolutions requesting climate-related disclosures, of which there were only 14 in 2020, rose at Fidelity, State Street Global Advisors, and Vanguard but fell at American Funds and BlackRock (BLK) from 2019.").

adhere to the Climate Action 100+ initiative)[58] could be attributable to contingent factors, and in particular to the widespread criticism that had been raised in previous months against BlackRock (along with the other major asset managers).[59] This criticism was due to the fact that, in the past, it had largely voted against proposals made by minority shareholders in favor of company policies focused on sustainability objectives.[60] In fact, empirical evidence relating to the US market shows that in 2019, many shareholder proposals submitted by minority shareholders in relation to ESG issues were not approved precisely as a result of the votes cast against them by BlackRock and the other major institutional investors.[61]

While it is possible that the circumstances mentioned above may have had some impact, the stance taken by BlackRock (and other leading institutional investors) on the issue of sustainability and the clear focusing of attention on the significance of the climate risk for investment activities appears to be entirely in keeping with the trend in this direction that has been apparent for some time within the asset management sector. Alongside the now innumerable statements by representatives of institutional investors, it is worth mentioning that recent change to the UK Stewardship Code—that has been at the heart of the worldwide diffusion of stewardship codes,[62] the most recent version of which (published on October 24, 2019) places ESG factors at the core of stewardship activities,[63] is certainly indicative of this trend. Significantly, principle 1 of the Code stresses that stewardship should seek to create long-term value for end investors and lead to sustainable benefits for the economy, the environment, and society.[64]

[58] Climate Action 100+ is an initiative promoted by around 545 investors at the international level, which seeks to encourage the main emitters of greenhouse gases to reduce the environmental impact of their operations. *See* CLIMATE ACTION 100+, http://www.climateaction100.org/ (last visited Feb. 28, 2021).

[59] For example, a stinging criticism of BlackRock's choice not to support the vast majority of shareholder proposals in the area of ESG was brought at the end of 2019 by former US Vice President Al Gore, who is currently involved in numerous environmental campaigns. *See* Richard Henderson, *BlackRock joins climate action group after 'greenwash' criticism*, FIN. TIMES (Jan. 9, 2020), https://www.ft.com/content/16125442-32b4-11ea-a329-0bcf87a328f2.

[60] *See* Attracta Mooney, *Nuns take on BlackRock over climate change*, FIN. TIMES (Dec. 15, 2019), https://www.ft.com/content/9f84e865-31ad-4a13-9398-8781e2cb0581.

[61] Jackie Cook, *ESG Proxy Resolutions Find More Support in 2019,* MORNINGSTAR (Feb. 28, 2019), https://www.morningstar.com/articles/967699/esg-proxy-resolutions-find-more-support-in-2019 ("[F]ive of the 10 largest fund families--Vanguard, BlackRock, American Funds, T. Rowe Price (TROW), and Dimensional Fund Advisors--voted against more than 88% of ESG-related shareholder resolutions.").

[62] *See generally* Ronald J. Gilson & Curtis J. Milhaupt, *Shifting Influences on Corporate Governance: Capital Market Completeness and Policy Channeling* 58 (Eur. Corp. Governance Inst., L. Working Paper No. 546/2020, 2021), http://ssrn.com/abstract_id=3695309 ("The stewardship concept took on a high profile with the adoption by the UK Financial Reporting Council's 2010 Stewardship Code").

[63] FIN. REP. COUNCIL, THE UK STEWARDSHIP CODE 4 2020 (2019), https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf ("Environmental, particularly climate change, and social factors, in addition to governance, have become material issues for investors to consider when making investment decisions and undertaking stewardship."); *see* Paul Davies, *The UK Stewardship Code 2010-2020 From Saving the Company to Saving the Planet?* 8 (Eur. Corp. Governance Inst., L. Working Paper No. 506/2020, 2020), https://ecgi.global/sites/default/files/working_papers/documents/davies5062020final.pdf.

[64] *See* FIN. REP. COUNCIL, *supra* note 63, at 8.

However, in view of this fact, it is not realistic to suppose that the increasingly widespread adoption of investment policies that are focused on sustainability is the result of any altruistic intentions on the part of institutional investors. This is moreover clearly apparent from a study published by BlackRock itself in 2020, which establishes how the increasing success of investment strategies incorporating sustainability considerations is due, first of all, to the conviction that they are likely to achieve higher returns at reduced risk, and secondly, to a progressive change in the preferences, and the very make up, of investors.[65]

As far as the former aspect is concerned, it is contended that an increase in attention by largely diversified institutional investors (like BlackRock) to ESG factors can lead to risk-adjusted return for their clients by mitigating systematic risk at a portfolio level.[66] It must however be pointed out that studies in this area are not unequivocal.[67] In fact, various empirical analyses have not identified any increase in the returns obtained by companies that pursue management strategies informed by sustainability considerations or in investment portfolios that include companies with better ESG ratings and performance.[68]

However, there is no doubt that there has been a progressive and irreversible shift in the preferences of end investors. In this respect, Larry Fink's 2020 and 2021 letters offer very significant indications, which demonstrate how the incorporation of ESG issues into investment policies is intended—perhaps above all—to attract the increasing share of clients that afford central attention to those aspects.[69] Demand for funds that incorporate ESG factors into investment strategies has been growing exponentially between 2010 and 2019.[70]

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[65] BLACKROCK, SUSTAINABILITY: THE TECTONIC SHIFT TRANSFORMING INVESTING 3 (2020), https://www.blackrock.com/us/individual/insights/blackrock-investment-institute/sustainability-in-portfolio-construction; *see also* Robert G. Eccles & Svetlana Klimenko, *The Investor Revolution*, HARV. BUS. REV., May–June 2019, https://hbr.org/2019/05/the-investor-revolution.

[66] *See* EUR. COMM'N, *supra* note 28.

[67] Davies, *supra* note 63, at 22.

[68] *See* Florencio Lopez-de-Silanes, Joseph A. McCahery & Paul C. Pudschedl, *ESG Performance and Disclosure: A Cross-Country Analysis* 2 (Eur. Corp. Governance Inst., Working Paper No. 418/2019, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3506084 ("ESG scores have little or no impact on risk-adjusted financial performance."); *see also* Patrick Bolton & Marcin T. Kacperczyk, *Do Investors Care about Carbon Risk?* 1 (Eur. Corp. Governance Inst., Working Paper No. 711/2020, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3398441 ("[S]tocks of firms with higher total CO2 emissions . . . earn higher returns"); Elizabeth Demers, Jurian Hendrikse, Philip Joos & Baruch Lev, ESG Didn't Immunize Stocks Against the COVID-19 Market Crash (Aug. 31, 2020) (unpublished manuscript), https://coller.tau.ac.il/sites/coller.tau.ac.il/files/media_server/Recanati/management/seminars/account/2021/DHJL_August31st.pdf ("[C]elebrations of ESG as an important resilience factor in times of crisis are, at best, premature."). However, as demonstration of how arguable the conclusions are in this area, it is interesting to note that indices based on ESG parameters appear to have withstood better the financial market crisis triggered by the spread of the Coronavirus in February and March 2020. *See* Gillian Tett, Billy Nauman, Patrick Temple-West & Andrew Edgecliffe-Johnson, *ESG shines in the crash; legal milestone for ratings*, FIN. TIMES (Mar. 13, 2020), https://www.ft.com/content/dd47aae8-ce25-43ea-8352-814ca44174e3.

[69] *Fink's 2020 Letter to CEOs*, *supra* note 22; *see also* Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Values(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243 (2020).

[70] BLACKROCK, *supra* note 65, at 4.

As Larry Fink himself notes, this has been the case not only for major investors such as pension funds and sovereign wealth funds but also for a large portion of retail investors, who are redirecting their capital to sustainable investment strategies at a steadily increasingly rate. Indeed, it may well be the case that "ultimate beneficiaries are people, and those people, as individuals, may prefer to see companies behave responsibly toward the communities with which they interact, even if profits suffer."[71] Moreover, this trend is set to increase as investment choices move into the hands of the millennial generation (that is, those born between 1981 and 1996), who—as is demonstrated by the initiatives taken by them to attract public attention to the effects of climate change—are particularly attuned to such issues.[72] A recent BlackRock study has stressed how demographic trends represent one of the main factors underlying this sea change, noting that the incorporation of sustainability factors into portfolio construction has represented a "tectonic shift" likely to transform the asset management sector.[73]

## IV. The Limitations of Institutional Investors' Commitment to ESG Investing

The points made above help to explain why the major institutional investors have been placing an increased focus on the sustainability of their investments, creating a growing number of sustainable products that incorporate ESG factors. However, none of this is sufficient in order to guarantee that the declarations and commitments made by the main institutional investors are translated into effective initiatives and do not by contrast amount mainly to mere pro forma assertions made essentially for "promotional" purposes in order to attract the growing share of clients who are sensitive to these issues.

Even if they are not followed by tangible initiatives, it is still certainly possible that statements such as those contained in the letters sent by BlackRock may have positive effects insofar as they are able to incentivize virtuous behavior by other investors.[74] Whilst conceding that a virtuous

[71] *See* Ann M. Lipton, *ESG Investing, or, If You Can't Beat 'Em, Join 'Em* 5 (Tulane Pub. L. Rsch. Paper No. 20-19, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3715935 ("The humans who stand behind mutual funds and pension plans may also benefit more from a clean environment, from safe consumer products, privacy protection, and affordable medicines, than from investment returns.").

[72] *Fink's 2020 Letter to CEOs*, *supra* note 22 ("[A]s trillions of dollars shift to millennials over the next few decades, as they become CEOs and CIOs, as they become the policymakers and heads of state, they will further reshape the world's approach to sustainability.").

[73] BLACKROCK, *supra* note 65, at 5 ("One contributing factor to the wave is, however, demographically induced: an ongoing transfer of wealth to a younger generation with greater awareness of sustainability. . . . Today's youth are increasingly financial decision makers whose tastes tilt toward sustainable products – and sustainable investments. The first of these preferences may result in a potential profitability boost for sustainable firms. The second preference will directly result in the repricing of more sustainable assets relative to less sustainable assets.").

[74] *See* Jason Mitchell, *Is greenwashing a necessary evil?*, FIN. TIMES (Feb. 12, 2020), https://www.ft.com/content/28688bd3-cc09-442e-ba53-43b1ff284408. Mitchell argues that so-called "greenwashing" (that is, the adoption of communications strategies that seek to establish a more positive image than what is actually the case in terms of environmental impact) by some investors may encourage others to adopt policies to contain environmental impacts, stimulating a reputational mechanism based on the perception that most sectoral actors are pursuing initiatives of this type. In this regard for instance, the fact that, following the publication of Fink's annual letters, State Street (the third largest asset manager in the world, and thus one of the biggest competitors of BlackRock) published a letter with similar content in which it reasserted the central focus on ESG factors in making its own investment choices is certainly significant.

effect of this type is possible, it is important however, not to overlook the fact that various circumstances give reason to doubt the effective capacity of institutional investors (including the largest investors) to pursue highly ambitious objectives, including in the general interest, such as those mentioned by Larry Fink to his clients and to managers of investee companies.

### A. Cost Issues

The effective capacity of institutional investors to provide tangible incentives for action by investee companies that are informed by sustainability objectives and to contain the pursuit of different short-term objectives is dependent, first and foremost, on the scale of the resources dedicated to achieving those objectives.

The increased commitment given in relation to the exercise of voting rights and engagement activities (that is, engagement in direct, generally confidential, contact with companies), which BlackRock and other major investors indicate as one of the main lines for intervention, will entail not insignificant costs. In fact, in order to be effective in promoting more virtuous conduct by investee companies, at least in some cases, company-specific analysis will be required, which in turn requires a sufficient number of human resources with specific expertise.

However, the evidence shows that the stewardship teams of the major institutional investors are significantly smaller than their actual requirements.[75] For example, in BlackRock's case it is estimated that investment in stewardship activity totals around 13.5 million dollars, which is equivalent to around 0.15% of the (estimated) asset management fees collected.[76] In addition, the number of people working on stewardship teams appears to be insufficient compared to the number of companies covered by stewardship initiatives. For example, at the present time there are forty-seven members of stewardship teams at BlackRock. Even though this figure is much higher than it is for any other institutional investor,[77] each of them in theory has the task of conducting stewardship activity in relation to around 500 companies,[78] with the inevitable result that the time dedicated to each of them is strictly limited and—in all likelihood—impossible to reconcile with a detailed analysis of each company.[79]

This appears to have been confirmed by recent empirical evidence,[80] which demonstrates how the three largest institutional investors in the world, BlackRock, Vanguard, and State Street, have

[75] *See e.g.*, Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029, 2077–80 (2019).

[76] *Id.* at 2078 (reporting that stewardship budgets of the Big Three "are economically insignificant relative to the fees that they charge").

[77] Attracta Mooney, *Jobs bonanza in stewardship and sustainable investing teams*, FIN. TIMES (Mar. 8, 2020), https://www.ft.com/content/2714da14-c12d-46b2-8ecf-9aba3f665fdf.

[78] Alastair Marsh, *BlackRock's Vow for Greener Planet to Get First Real-World Test*, BLOOMBERG (Mar. 4, 2020), https://www.bloomberg.com/news/articles/2020-03-02/blackrock-s-vow-for-greener-planet-to-get-first-real-world-test (reporting the general view amongst sectoral experts that each professional can effectively manage a maximum of 30 or 40 companies); *see also* Julian Franks, *Institutional Ownership and Governance*, 36 OXFORD REV. ECON. POL'Y 258, 266 (2020).

[79] *See generally* Sharfman, *supra* note 30, at 20–22.

[80] *See* Cook, *supra* note 61.

followed their own voting policies in relation to resolutions on ESG issues for at least 75% of funds under management. This accordingly confirms that, given their limited size, stewardship teams are unable to carry out specific checks in relation to a large number of portfolio companies, in relation to which they do not carry out any engagement activity and apply pre-determined voting policies, or rely on the assistance of proxy advisors, the accuracy of whose analyses is, as is known, a matter of debate.

As further confirmation of the above, it is important to note that, whilst the frequency with which institutional investors support the shareholder proposals presented by minority shareholders and ESG associations of investors has risen significantly, all of the investors that have voted most often in favor of ESG proposals manage mainly active funds, and only one of them is ranked amongst the top ten asset managers.[81]

### B. The Rise of Passive Investing

It may be highlighted, with reference to the above, how the dissemination of passive funds (that is, portfolios that track a particular benchmark equity index) is a factor that can impinge upon the effective capacity of asset managers to encourage the adoption by investee companies of policies that pursue sustainability objectives. As passive fund managers do not have any opportunity to sell the equities included in the benchmark index, passive funds are unable to use the threat of divestment as a way of exerting pressure on the companies included in the portfolio in order to incentivize particular choices by them; by contrast, they can only rely on the exercise of voting rights and engagement.

The terms of the debate in this area are now well-known. According to one view, which is promoted by all of the major asset managers, since they are of necessity long-term investors ("permanent" according to the definition used by Larry Fink), managers of indexed funds have an interest in monitoring very closely the companies in which they hold shares. On the other hand, others argue that managers of passive funds do not have adequate incentives to act in this manner. First of all, the costs associated with stewardship impinge much more significantly on managers' income as passive funds have much lower fees. In addition, in many cases no performance fees are provided for in relation to passive funds, but rather only subscription fees proportional to the amounts invested in the fund: therefore, managers do have a limited incentive to allocate funds to stewardship activities with the aim of improving the fund's return.[82] This is also in view of the fact

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[81] *Id.*; *see also* Richard Henderson & Michael Mackenzie, *BlackRock assets climb to record $7.8tn in third quarter*, FIN. TIMES (Oct. 13, 2020), https://www.ft.com/content/12556749-53fd-4e88-a67e-2d5ceb20b71e (reporting that BlackRock "has punished 53 companies in annual meetings this year over climate change, but has faced criticism for backing just 6 per cent of climate-related shareholder votes in the year through June, down from 8 per cent in the previous year").

[82] *See generally* John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve* 19 (Harvard Pub. L., Working Paper No. 19-07, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3247337; Marcel Kahan & Edward Rock, *Index Funds and Corporate Governance: Let Shareholders Be Shareholders* 1, 26–28 (Eur. Corp. Governance Inst.,Working Paper No. 467, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3295098.

that, subject to a limited number of exceptions, passive funds register higher returns than active funds.[83]

In addition, the BlackRock letters cast light on two aspects that had previously not been sufficiently considered within the debate into the dissemination of passive investment strategies.

First of all, it is important to focus on BlackRock's aim to increase the offer of passive funds the benchmark indices for which include companies that fulfill particular requirements in terms of their ESG profiles and that pursue suitable policies in the area of sustainability.[84] This confirms the growing popularity of passive funds, which are passive in name only since the composition of the index results in investment choices being made that are de facto similar to those made by actively managed funds.[85] In other words, in these cases the fund invests in the equities featured in an index that has been created on an ad hoc basis for the specific fund by its own manager. In view of this, the exponential growth in the offer of "socially responsible" passive funds could incentivize greater investment by managers in stewardship initiatives aimed at promoting sustainability policies.[86] Even if there are no performance-related fees, actions of this type by managers could in fact help to reinforce the fund's socially responsible aspect, thereby attracting investors that are more sensitive to these issues, and hence resulting in a return in terms of fees that could justify greater investments in stewardship.[87]

The problem evidently arises in different terms where—as is the case for larger passive funds and ETFs—they track a third-party index, the composition of which the fund manager cannot as a rule influence. This is clear from the letter sent by top managers at BlackRock to their own clients, which clarifies that the intention of selling any listed securities (bonds and equities) in companies that generate more than 25% of their revenues from the production of thermal coal is limited to active funds only. It is clearly not possible to adopt this type of policy for passive funds that track a standard index, such as the Russell 3000 or the S&P 500, as they are required to maintain the securities of the companies concerned in their portfolios for as long as they feature in the benchmark index.

In order to avoid this restriction, as mentioned above, BlackRock has stated its intention to work together with index providers not only in order to expand and improve the offer of sustainable indices but also in order to promote the creation of sustainable versions of their leading indices. This intention highlights, first and foremost, the crucial importance of index providers—and above all the three main operators, MSCI, S&P Dow Jones Indices, and FTSE Russell, which hold a

[83] *See generally* Bebchuk & Hirst, *supra* note 75.

[84] *See* BlackRock's Global Executive Committee's 2021 Client Letter, *supra* note 55 (stating that, in 2021, BlackRock "will launch investment products with explicit temperature alignment goals, to allow clients to achieve their net zero objectives").

[85] *See* Adriana Z. Robertson, *Passive in Name Only: Delegated Management and Index Investing*, 36 YALE J. ON REG. 795, 833–41 (2019); *see also* Billy Nauman, *Direct indexing allows investors to pick and mix*, FIN. TIMES (Jan. 9, 2021), https://www.ft.com/content/609e1652-d12c-4aef-9656-80d284c1a1f1.

[86] *But see* Raghunandan & Rajgopal, *supra* note 7, at 29 ("[M]etrics used by ESG investors in their portfolio allocation decisions do not appear to be correlated with actual ESG fundamentals in the form of firms' compliance records.").

[87] *See* Lipton, *supra* note 71, at 8–9.

market share of 80%—as a result of the exponential dissemination of passive funds. By defining the criteria on which inclusion in any given index is based, index providers are able to act as genuine gatekeepers that are capable of influencing the actions of listed companies in a manner that is in some respects more far reaching than institutional investors.[88] In the future therefore, index providers could play a decisive role in promoting choices based on sustainability considerations by listed companies by setting standards of conduct and parameters relating to ESG considerations, compliance as a prerequisite for incorporation into or continued inclusion in any given index.[89]

However, it is doubtful whether cooperation between the major asset managers and index providers could result in the exclusion of companies that do not comply with particular ESG standards from the most widely used indices (that is, the benchmark indices for the various equity markets, such as the S&P 500 or Russell 3000).

First of all, index providers do not actually appear to have any intention of performing the role of gatekeepers that they could carry out, by exploiting the influence associated with the power to exclude a company from the index.[90] A good example of this is how companies with dual class structures have been treated on the US market. Following an IPO launched by the company Snap Inc., which envisaged a public offer only of non-voting shares, some institutional investors asked index providers to exclude companies with dual class share structures from indices. However, the response of the three main index providers was lukewarm and did not result in the adoption of strict requirements for incorporation into or continued inclusion in the main indices.[91] In addition, in some cases, although they did not approve of some particular decisions taken by some of the listed companies included in the benchmark indices, the managers of index funds themselves were opposed to those companies being excluded from the index.[92] For example, BlackRock did not view positively the proposal by MSCI to limit the weight of companies with dual class share structures within the indices offered, pointing out that this could have a negative impact on those investing in the index as the exclusion of some companies could result in a situation in which the index was no longer able to provide an "accurate representation of the investable universe."[93] In addition, according to a view proposed by some scholars, the exclusion from benchmark indices

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[88] *See* Johannes Petry, Jan Fichtner & Eelke Heemskerk, *Steering capital: the growing private authority of index providers in the age of passive asset management*, 28 REV. INT'L POL. ECON. 152 (2021).

[89] *Id.* at 171.

[90] *See* Scott Hirst & Kobi Kastiel, *Corporate Governance by Index Exclusion*, 99 B.U. L. REV. 1229, 1263–66 (2019).

[91] For example, to be included in FTSE Russell's indexes, companies must have at least 5% of their voting rights held by unrestricted public shareholders. *See id.* at 1265 (noting that FTSE Russell's dual-class exclusion is likely to have an even weaker deterrent effect).

[92] *Id.* at 1248–50.

[93] Letter from Barbara Novick, Vice Chairman, BlackRock, to Baer Pettit, President, MSCI, Inc. (Apr. 19, 2018), https://www.blackrock.com/corporate/literature/publication/open-letter-treatment-of-unequal-voting-structures-msci-equity-indexes-041918.pdf.

of companies with dual class share structures could have a negative impact on the return of index funds that track them.[94]

All of this makes it highly unlikely that passive funds will also be able to achieve some of the objectives set by BlackRock for its own active funds, such as BlackRock's divestment of listed securities in companies that generate more than 25% of their revenues from the production of thermal coal, which is limited to active funds only.[95]

## V. Conclusions: Market Forces are not Enough to Promote Sustainable Finance

In conclusion, the basic question raised by assertions such as those contained in the letters sent by Larry Fink and by top managers at BlackRock in 2020 is whether institutional investors (and in particular the largest investors) have an effective interest in implementing initiatives aimed at encouraging investee companies to adopt policies focused on sustainability and ESG considerations and also, in more general terms, in pursuing investment strategies that are aimed at fulfilling more general objectives, such as a reduction in $CO_2$ emissions, the benefits of which are destined to be felt not only by end investors but also by society in general.

As noted above, stewardship activities that seek to promote sustainable conduct by investee companies require institutional investors to bear not insignificant costs, which impinges upon the results generated by managed funds. Ultimately therefore, the expectation that institutional investors will invest resources with the aim of promoting socially responsible conduct and achieving particular objectives associated with ESG considerations implies an internalization of costs by institutional investors,[96] the effects of which will be felt not only by them (in terms of lower net earnings) but also by end investors (in terms of lower returns). Therefore, even assuming that largely diversified institutional investors (like BlackRock, Vanguard, and State Street) adopt a portfolio value maximization approach according to which they can push ESG policies that can impair the value of some portfolio companies while benefiting some others,[97] the fact remains that "[a] rational owner would use his power to internalize externalities so long as its share of the cost to the externality-causing firms are lower than the benefits that accrue to the entire portfolio from the elimination of the externality."[98]

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[94] Andrew Winden & Andrew Baker, *Dual-Class Index Exclusion*, 13 VA. L. & BUS. REV. 101, 151 (2019) ("[B]ecause retail investors in the United States are increasingly invested in index funds, they have the most to lose if the index providers persist in excluding or reducing the weighting of dynamic growth companies with multi-class capital structures from their benchmark indices.").

[95] *See* Jasper Jolly, *Asset manager BlackRock threatens to sell shares in worst climate polluters*, THE GUARDIAN (Jan. 26, 2021), https://www.theguardian.com/business/2021/jan/26/asset-manager-blackrock-threatens-to-sell-shares-in-worst-climate-polluters (reporting that BlackRock "will retain vast holdings in fossil fuel companies because of its role in providing funds that passively track investment indices, about 90% of its holdings. Even after the thermal coal pledge BlackRock owns assets worth $85bn in coal-producing companies.").

[96] Andrew Johnston, Kenneth Amaeshi, Emmanuel Adegbite & Onyeka Osuji, *Corporate Social Responsibility as Obligated Internalisation of Social Costs*, J. BUS. ETHICS (2019), https://doi.org/10.1007/s10551-019-04329-y.

[97] *See* Enriques, *supra* note 15.

[98] *See* Condon, *supra* note 26, at 6.

In addition, it is important to take account of the fact that, within this context, a further disincentive may result from potentially opportunistic conduct (attributable to the classic collective action problem) by some institutional investors that avoid taking any action with a view to reaping the benefits of initiatives pursued by other investors.

All of this leads us to doubt whether institutional investors can perform a "public" function for the benefit of society at large and replace governmental or regulatory intervention.

First and foremost, public intervention is necessary in order to introduce measures aimed at limiting the effect of potential disincentives for institutional investors. These may include—according to the various proposals already made in this area—an obligation to invest adequate resources in stewardship activities or a modification of the fiduciary duties applicable to institutional investors requiring such an outcome.[99] It may also entail the introduction of a tax regime that creates incentives for incurring costs in relation to stewardship initiatives and more generally, to promote sustainable strategies by investee companies, or the transfer of the related costs to end investors.[100] Each one of these possible forms of intervention will entail significant redistributive effects and ultimately will determine which particular class of operator involved will be required to bear the cost of activity that is intended to benefit society as a whole (consider for example a reduction of $CO_2$ emissions), and on what scale.

In addition, on an even more general level, it is even more illusory to assume that institutional investors will accept the burden of pursuing objectives of general interest, essentially acting in place of the state, especially with regard to issues related to sustainability, and more particularly environmental protection and social policies. Larry Fink himself has stated in relation to this matter that the transition to a low-carbon economy is a "challenge [that] cannot be solved without a coordinated, international response from governments,"[101] and corporations and institutional investors will only be able to play a significant role if governments pave the way through necessary reforms.[102] For example, it is implausible to rely excessively on an expectation that climate change can be avoided by institutional investors systematically selling (where active investment strategies are adopted) securities in companies that produce thermal coal without any additional legislative measures to promote the conversion of the still high number of industrial facilities powered by that fuel, demand for which remains high especially in certain geographical areas.[103]

[99] Bebchuk & Hirst, *supra* note 75, at 2119–22.

[100] *See* Adi Libson & Gideon Parchomovsky, *Reversing the Fortunes of Active Funds*, 99 TEX. L. REV. 581, 586 (2021). Libson and Parchomovsky suggest adopting an effort-based tax credit that "can be used to reward institutional investors that incur specific expenses associated with corporate activism—for example, an engagement in a proxy contest or corporate governance analysis—irrespective of the ultimate result" and a result-based tax credit that "would be awarded to successful activists whose efforts bear fruit." *Id*.

[101] *See Fink's 2020 Letter to CEOs*, *supra* note 22.

[102] *See* Davies, *supra* note 63, at 28 ("[I]t is necessary, in the government's eyes, to co-opt corporate managers and those in a position to influence them in the pursuit of environmental targets.").

[103] *See* Bolton & Kacperczyk, *supra* note 68, at 32 ("Divestment takes place in a coarse way in a few industries such as oil & gas, utilities, and automobiles and is entirely based on scope 1 emission screens . . . outside the salient industries where all the divestment takes place, we find a robust, persistent, and significant carbon premium at the firm level for all three categories of emission levels and growth rates.").

From another viewpoint, even if it is assumed that "market forces" will be sufficient on their own without any need for intervention by governments or supervisory authorities,[104] to assign a central role to institutional investors by vesting them with the task of pursuing objectives of general interest would be to pursue a strategy that is potentially inadvisable in terms of collective wellbeing, at least until the consequences of increasing concentration in the asset management sector have been clarified. In fact, various commentators have highlighted (although the issues need to be scrutinized further, given the differences of opinion in relation regarding this issue)[105] the potential anti-competitive effects resulting from "common ownership" (that is, the fact that the same institutional investors are shareholders of companies operating within a given sector).[106] These effects might reasonably be expected to be amplified by any further reinforcement of the position of the major institutional investors and due to their tendency to adopt voting and engagement policies that are substantially uniform.[107]

[104] *See* Eugene F. Fama, *Market Forces Already Address ESG Issues and the Issues Raised by Stakeholder Capitalism*, PROMARKET (Sept. 25, 2020), https://promarket.org/2020/09/25/market-forces-esg-issues-stakeholder-capitalism-contracts/.

[105] *See generally* Jennifer Hill, *The Conundrum of Common Ownership* (Eur. Corp. Governance Inst., L. Working Paper No. 5000/2020, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3546886.

[106] *See generally* Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267 (2016).

[107] Editorial Board, *The BlackRock Backlash: Larry Fink's political machinations invite regulatory scrutiny*, WALL ST. J. (Feb. 27, 2020), https://www.wsj.com/articles/the-blackrock-backlash-11582849130.