



ICGN

International Corporate Governance Network

.....

ICGN Guidance on Institutional Investor Responsibilities

.....

Influencing • Connecting • Informing



Published by the International Corporate Governance Network
16 Park Crescent
London W1B 1AH UK

© International Corporate Governance Network 2013

All rights reserved. Dissemination of the contents of this paper is encouraged. Please give full acknowledgement of the source when reproducing extracts in other published works.

ICGN, the contributors and the editor of this publication accept no responsibility for loss occasioned by any person acting or refraining from action as a result of any views expressed in these pages. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

British Library Cataloguing in Publication Data

A catalogue record for this book is available from the British Library

ISBN 978-1-907387-13-5

ICGN Statement of Principles for Institutional Investor Responsibilities

About ICGN

An investor-led organization of governance professionals, ICGN's mission is to inspire and promote effective standards of corporate governance to advance efficient markets and economies world-wide. Established in 1995 and present in over 50 countries, the ICGN membership includes global investors with assets under management in excess of US\$18 trillion. For more information, contact the ICGN Secretariat by telephone: +44 (0) 207 612 7098, email: secretariat@icgn.org or visit www.icgn.org.

Preamble

These principles set out the ICGN's view of current best practices in terms of the responsibilities of institutional investors both in relation to their internal governance and with regard to their external role as investors in companies and other assets. Both help to ensure that institutions deliver fully and effectively their obligations to their beneficiaries and clients, and thereby also help support the positive economic performance of companies and the broad markets in which they invest, helping foster sustainable growth and job creation.

Responsible investment requires high standards of transparency, probity and care on the part of institutions, which may be met by adhering to these Principles. The standards set out here are intended to apply, with appropriate flexibility, to all investment styles and approaches. They are aspirational standards that the ICGN encourages member organisations and their peers to seek to adhere to as appropriate to their circumstances and over time.

Institutional investors' obligations to their beneficiaries or clients and their scope for influence of companies in which they invest bring important responsibilities. These responsibilities take different forms, extending from formal rights to exercise votes or to put matters formally in front of other investors, to informal scope for exercising influence on management and boards across a range of key matters. The varying roles of different forms of institutional investor are outlined in the section called 'Overview of the investment chain', and also in the section on 'key concepts and definitions'. Ultimate owners cannot delegate these underlying responsibilities; even when they employ agents to act on their behalf, beneficial owners need to ensure that the responsibilities of ownership are appropriately and fully delivered in their interests and on their behalf by those agents.

As sophisticated investors with influence, often including voting rights, institutional investors have a unique leadership opportunity to encourage appropriate behaviours by their investee companies. They should play an active role as responsible investors, promoting corporate governance and other best practices at investee companies by engaging with them on pertinent financial and other relevant matters. This should help foster sustainable long-term performance by these companies to the benefit of all investors. In this way, investment institutions will be fulfilling their core role as a fiduciary, mandated to invest in the interests of their ultimate clients or beneficiaries. They are likely best to be able to deliver effectively for their clients or beneficiaries over appropriate time-horizons where their internal governance is established in a way giving them the skills, capacity and structures to focus appropriately on client or beneficiary interests. In considering what time-horizons are appropriate, institutional investors will need to consider the best interests of their clients and beneficiaries, and any issues of intergenerational fairness between them as well as where the ultimate risk-bearing lies within the institutional investor.

The ICGN has summarised the key obligations of institutional investors into 12 high-level principles, six for obligations in relation to internal governance and six concerning their external role as investors. For each of these principles, the ICGN provides guidance on how these principles can be approached and may be delivered. While practice will vary in detail between national markets, the principles that underlie high standards are constant. Good practice continues to develop; the ICGN will continue to keep these principles and the guidance under review, and welcomes input from interested parties over time.

Contents

| | | |
|-----|--|----|
| 1.0 | Principles for Internal Governance | 6 |
| 2.0 | Principles for External Responsibilities | 7 |
| 3.0 | Guidance on Principles for Internal Governance | 8 |
| 4.0 | Guidance on Principles for External Responsibilities | 12 |
| 5.0 | Overview of the investment chain | 17 |
| 6.0 | Key concepts and definitions | 20 |
| 7.0 | Annexes | 22 |

1.0 Principles for Internal Governance

1.1 Fiduciary duty

The culture, activities and role of all institutional investors should focus on delivering value to the benefit of beneficiaries or clients over the appropriate time-horizon.

1.2 Independent oversight

Institutional investors should be led by boards or other governance structures that act independently and without bias, advancing beneficiary or client interests as their primary obligation.

1.3 Capacity and effective management

Institutional investors should be led by boards and staff with the appropriate capacity and experience to oversee effectively and manage all relevant activities in the interests of beneficiaries or clients.

1.4 Conflicts of interest, codes of ethics, compliance

Institutional investors should understand, minimise and manage the conflicts of interest that they face and behave ethically, ensuring that they maintain focus on advancing beneficiary or client interests and disclosing any conflicts transparently to them.

1.5 Appropriate remuneration structures

Institutional investors' pay structures should reinforce their culture and focus on advancing beneficiary or client interests over appropriate time-horizons, and should be transparently communicated to beneficiaries or clients.

1.6 Transparency and accountability

Institutional investors should be transparent and open with their beneficiaries or clients so as to be fully accountable for the effective delivery of their duties.

2.0 Principles for External Responsibilities

2.1 Establishment and application of consistent policies

Institutional investors should adopt and disclose clearly stated, understandable and consistent policies to guide their approaches to key issues within their investment universe. These policies should be communicated to clients and beneficiaries in plain and understandable language.

2.2 Active monitoring

Institutional investors should monitor closely the companies in which they invest in order to assess their individual circumstances, performance and long-term potential, and to consider whether there is value in intervening to encourage change.

2.3 Proactive engagement

Institutional investors should engage intelligently and proactively as appropriate with investee companies on risks to long-term performance in order to advance beneficiary or client interests.

2.4 Delivery of informed voting decisions

Institutional investors should make informed and independent voting decisions at investee companies, applying due care, intelligence and judgement.

2.5 Participation in relevant policy dialogues

Institutional investors should engage as appropriate in the development of relevant public policy and best practices in order to advance beneficiary or client interests.

2.6 Collective engagement

Institutional investors should act collectively as appropriate where this would assist in advancing beneficiary or client interests, taking account of relevant legal and regulatory constraints.

3.0 Guidance on Principles for Internal Governance

3.1 Fiduciary duty

The culture, activities and role of all institutional investors should focus on delivering value to the benefit of beneficiaries or clients over an appropriate time-horizon.

An investment institution's investment policy and mandates with services providers should be consistent with the objective of delivering value over the long term for the benefit of beneficiaries or clients.

The over-arching obligation of every investment institution is to promote and safeguard the interests of beneficiaries or clients. This is often expressed as a fiduciary duty, requiring prudence, care and loyalty on the part of all agents which are subject to such obligations. Ultimate owners should actively consider which of their agents should be subject to the strictures of fiduciary duty and if such requirements are not applied what lower standards of required behaviour are appropriate.

Ultimate owners cannot delegate their underlying fiduciary duties; even when they employ agents to act on their behalf, beneficial owners need to ensure through contracts or by other means that the responsibilities of ownership are appropriately and fully delivered in their interests and on their behalf by those agents, who are to be held to account for doing so.

While intermediaries in the institutional investment chain play different roles, each should focus on the needs of its beneficiaries or clients such that it is always seeking to deliver value over their required time-horizon. Benchmarks for measuring success should be tailored to the needs and risk exposures of beneficiaries or clients, with reporting designed to provide them with an understanding of success toward meeting those needs and managing related risks, in addition (as relevant) to providing applicable market-relative performance numbers.

Risk policies established by institutional investors need to take account of the underlying risks faced by beneficiaries and clients. There is a discussion of some of the relevant issues in the ICGN's *Model Mandate Initiative*. In particular, policies need to take account for who or what ultimately bears the risk given the structure of the nature of the liabilities of the investment institution.

3.2 Independent oversight

Institutional investors should be led by boards or other governance structures that act independently and without bias, advancing beneficiary or client interests as their primary obligation.

Institutional investors should have a governance structure that provides for the interests of beneficiaries properly and fully to be taken into account. Institutional investors will best be able to focus fully on the needs of their beneficiaries or clients where their governance structures leave them free from bias and independent of competing interests.

All decisions should be taken in the interests of the beneficiaries or clients. Their governing bodies should therefore have a structure and constitution that reflects this and should be disclosed on an ongoing or regular basis to beneficiaries and clients, together with explanations as to how such arrangements address alignment with beneficiary interests.

They should have mechanisms in place to solicit and receive ongoing feedback from beneficiaries and respond to their concerns. They should also make use of regular independent reviews of their internal governance structures, and respond to any recommendations arising from them, to ensure that they meet expectations of accountability.

Governing bodies, and where relevant, individuals in a fiduciary position of responsibility for ultimate investors, such as pension fund trustees and representative boards, should be aware of their primary oversight role. They should be clear about the objectives of their beneficiaries or clients, communicate them to portfolio managers and other agents employed and ensure they are being met. They need to oversee actively, the management of risk and the work of all their agents such that they deliver fully in the interests of the beneficiaries or clients over appropriate time-horizons.

In considering what time-horizons are appropriate, institutional investors will need to consider the best interests of their clients and beneficiaries, and any issues of intergenerational fairness between them as well as where the ultimate risk-bearing lies within the institutional investor. They should make clear which, if any, public or regulatory authorities have responsibility to monitor and enforce their fiduciary functioning.

The way in which individuals are appointed to serve on the governing body should be disclosed to beneficiaries and others as well as the criteria that are applied to such appointments. Such criteria should always take account of the need for expertise and understanding of the matters for which the governing body is responsible. Governing bodies, particularly of institutional investors where the beneficiaries or clients face the underlying investment risk, also need to include representatives of those beneficiaries or clients to build confidence in the collegiality of interests between them. They should reflect the diversity of interests of those whom they represent.

Independent decision-making is easier to achieve if the structure of the governing body includes representation from relevant interests. In particular it is not desirable that the plan sponsor or employer dominate the governing body. Where this is the case, consideration should be given to the representation of individuals accountable to beneficiaries even if this is not mandatory. A serious conflict of interest may also arise where the plan sponsor is a government or other public authority which may have an interest in taking stewardship and investment decisions that reflect public policy objectives rather than the interests of the beneficiaries. Where this is the case there is an additional need to ensure a majority of independent participants or beneficiary representatives on the governing body.

3.3 Capacity and effective management

Institutional investors should be led by boards and staff with the appropriate capacity and experience to oversee effectively and manage all relevant activities in the interests of beneficiaries or clients.

Decision-makers along all parts of the investment chain should be appropriately resourced and meet relevant standards of experience and skill in matters subject to deliberation. All should have appropriate training and induction processes made available to them, and should be able to allocate sufficient time both to that training and induction and to ongoing decision-making.

Governing bodies should have the right to outside advice, independent from any received by the sponsoring body; they need to have the capacity critically and prudently to evaluate any advice received and to take appropriate decisions themselves, not simply defer to that advice. Portfolio managers and others in a similar agency position should deploy sufficient, qualified resources properly to deliver on clients' expectations. Institutional investors should be able to justify to beneficiaries or clients specific actions taken on their behalf whether by themselves or by their agents. Institutional investors will remain accountable for the delivery of actions even where they have delegated the day-to-day responsibility for carrying them out.

Where an investment institution is not of sufficient scale to have governance structures or internal resources such that it is capable of such effective oversight on behalf of beneficiaries or clients, it should consider ways to consolidate, collaborate or build scale such that it is capable of this necessary oversight. This may require dialogue with policymakers and government authorities to facilitate such developments.

3.4 Conflicts of interest, codes of ethics, compliance

Institutional investors should understand, minimise and manage the conflicts of interest that they face and behave ethically, ensuring that they maintain focus on advancing beneficiary or client interests and disclosing any conflicts transparently to them.

Conflicts of interest will inevitably arise from time to time. It is of paramount importance that these are recognised and addressed by governing bodies and other agents in the chain, if the overarching principle of safeguarding the interest of beneficiaries is to be respected. Those acting as agents should disclose all known potential conflicts of interest to their principal and explain how these are dealt with so as to protect their beneficiaries' or clients' interests. The responsibility for disclosure of conflicts extends at least to the next level up in the investment chain. All institutional investors should have clear policies for managing conflicts in the interests of the beneficiaries and ensuring that they are adhered to.

Institutional investors need to have effective programmes for dealing with compliance matters and should also consider their obligations to beneficiaries or clients in terms of broader ethical considerations. They need to manage bribery and corruption, money laundering and other like risks appropriately and effectively. They should operate robust policies to deal with inside information and to avoid market manipulation.

3.5 Appropriate remuneration structures

Institutional investors' pay structures should reinforce their culture and focus on advancing beneficiary or client interests over appropriate time-horizons, and should be transparently communicated to beneficiaries or clients.

Institutional investors should reinforce their obligations to act fully in the interests of beneficiaries or clients by setting fee and remuneration structures that provide appropriate alignment over relevant time-horizons. In large part this will require the structure for fees paid to parties in the investment chain to be more associated with the long-term perspectives which will generate returns over the time-horizon that beneficiaries and clients are seeking. Collective investment vehicles may also seek transparency of the remuneration structures for individuals within the agents that they hire, in particular to gain reassurance that these provide appropriate incentives to those individuals. In particular, they may wish to assure themselves that pay structures for individuals do not inappropriately incentivise risk-taking behaviours. Consideration should be given to including a long-term performance incentive that reflects long-term investment results or is in the form of an interest in the fund that extends through the period

of responsibility for the investments. Best practice is for institutional investors to disclose to their beneficiaries and clients an explanation of how their remuneration structures and performance horizons for individual staff members advance alignment with the interests of beneficiaries and clients. Asset owners may wish to ensure that remuneration frameworks do not unduly constrain their ability to attract and retain well-qualified personnel.

Remuneration plays a crucial role in establishing and maintaining the culture of an organisation. This means that institutional investors will need to consider the appropriate balance in their pay structures between base pay and incentives, the nature of performance which is subject to incentivisation and the period over which performance is measured in order to trigger awards. Having greater proportions of variable rewards deferred for longer periods of time and subject to claw-back or malus structures, particularly if the deferred awards are invested alongside beneficiaries or clients, is likely to help instil the right mindset and culture. This is likely to set a better context for the delivery of value over the appropriate time period for beneficiaries and clients.

3.6 Transparency and accountability

Institutional investors should be transparent and open with their beneficiaries or clients so as to be fully accountable for the effective delivery of their duties.

Institutional investors should disclose to their beneficiaries or clients material aspects of governance and organisation, such that those beneficiaries and clients can hold them effectively accountable for their structures and actions. In particular, they should actively consider which aspects of these Principles they should disclose transparently.

Institutional investors should seek a clear set of objectives and expectations from their clients and beneficiaries, in particular with regard to their investment time-horizon.

4.0 Guidance on Principles for External Responsibilities

4.1 Establishment and application of consistent policies

Institutional investors should adopt and disclose clearly stated, understandable and consistent policies to guide their approaches to key issues within their investment universe. These policies should be communicated to clients and beneficiaries in plain and understandable language.

Just as it is important for beneficiaries to be informed of the governance policies adopted by those that act for them, so it is important for companies to be aware of the policies that shareholders are likely to adopt. In most markets this has been made easier by the development of corporate governance codes, which set standards to which companies are encouraged to adhere. Nonetheless, institutional investors will not always feel themselves bound by such national standards but may seek to encourage the application of international best practices. The overall approach of institutional investors to these issues is sometimes referred to as 'stewardship' and a growing number of markets have, or are, developing Stewardship Codes or the equivalent. 'Stewardship' is not a term used in this document because it is less well understood in some parts of the world; nonetheless, the discussion of external responsibilities which follows should be understood in this context.

As highlighted in the section ‘Accountability in the investment chain’, the standards set by institutional investors in these respects should help inform their selection of portfolio managers and other agents.

Risk policies established by institutional investors need to take full account of the underlying risks faced by beneficiaries and clients. In particular, policies need to take account of who, or what, ultimately bears the risk given the structure of the nature of the liabilities of the institutional investor.

4.2 Active monitoring

Institutional investors should monitor closely the companies in which they invest in order to assess their individual circumstances, performance and long-term potential, and to consider whether there is value in intervening to encourage change.

Institutional investors should be clear what standards they are applying, and how they monitor investee companies. Monitoring should be regular, and include: maintaining awareness of the company’s ongoing performance, as well as any developments within and external to the company that might affect its value and the risks it faces; assessing the effectiveness of the company’s governance and leadership; and considering the quality of the company’s reporting. Monitoring may involve relevant meetings and discussions with company management and non-executive directors, and where appropriate and practicable attendance at shareholder meetings.

Institutional investors should seek to identify as early as possible problems that put significant investment value at risk. If they have concerns they should seek to ensure that the appropriate members of the investee company’s board or management are made aware of them. Institutional investors should carefully consider explanations given for any departure from relevant corporate governance codes and make reasoned judgements. Where this could lead to a negative vote or an abstention at a general meeting, the investee company’s board should be informed of this, ideally in writing, and of the reasons for the decision, at least in respect of significant holdings.

Alongside the work of monitoring investee companies, asset owners will also seek to monitor the activities and effectiveness of their fund managers and other agents, holding them to account for delivery over time according to relevant mandates. These issues are discussed in the ICGN’s *Model Mandate Initiative* (2012).

Institutional investors should periodically measure and review the effectiveness of their monitoring and ownership activities and communicate the results to their clients or beneficiaries, in such a way as to enhance their understanding without compromising specific engagement efforts.

4.3 Proactive engagement

Institutional investors should engage intelligently and proactively as appropriate with investee companies on risks to long-term performance in order to advance beneficiary or client interests.

‘Engagement’ can be described as purposeful dialogue with investee companies with the aim of preserving or enhancing value on behalf of beneficiaries or clients. Effective engagement requires an adequate skillset and framework to encourage and effect necessary change. It is typically an extension of monitoring activities and arises when institutional investors have a close and full understanding of the specific circumstances of the investee company and identify concerns about its performance, governance or risk management. Voting is an element of engagement – and responsible investors should make use of their voting rights – but it is only one element of the appropriate activities.

When engaging with companies about governance issues, institutional investors should respect market abuse rules and not seek trading advantage through possession of price sensitive information. Where appropriate and feasible, they may consider formally becoming insiders in order to support a process of longer term change. At the outset of engagement with companies they should make it clear whether or not they wish to become insiders. They should encourage companies to ensure that all sensitive information and decisions resulting from engagement are at the right time made public for the benefit of all shareholders.

Institutional investors should have a clear approach for dealing with situations where dialogue is failing. This should be communicated to companies as part of their corporate governance policy. Steps that may be taken under such an approach include: expressing concerns to other corporate representatives or non-executive directors, either directly or in a shareholders’ meeting; making a public statement; submitting resolutions to a shareholders’ meeting; submitting one or more nominations for election to the board as appropriate and convening a shareholders’ meeting. In some circumstances and in certain jurisdictions, some investors may feel it appropriate to seek governance improvements and/or damages through legal remedies or arbitration.

4.4 Delivery of informed voting decisions

Institutional investors should make informed and independent voting decisions at investee companies, applying due care, intelligence and judgement.

Voting is a key investor right and an asset of the ultimate beneficiaries. Voting rights should therefore be exercised with due care and diligence, and institutional investors should ordinarily seek to exercise all voting rights. A high voting turnout at general meetings will help ensure that decisions are sound and representative.

Votes should be exercised in a considered manner; where an agent is employed to support decision-making the ultimate authority and responsibility remains with the collective investment vehicle. Institutional investors should seek to reach a clear decision either in favour or against each resolution.

In defined or specific cases, institutional investors may wish to abstain in order to signal to the company. In either case the reason for the decision should be properly communicated to the company. Where an institutional investor chooses not to vote in specific circumstances, or in particular markets or where holdings are below a certain scale threshold, this should be clearly disclosed to clients or beneficiaries.

Voting is not an end in itself but an essential means of ensuring that boards are accountable and fulfilling the stewardship obligation of institutional investors to promote the creation of value. Institutional investors should therefore seek to vote their shares in a considered way and in line with this objective. They should develop and publish a voting policy so that beneficiaries and investee companies can understand what criteria are used to reach decisions. Voting decisions should reflect the specific circumstances of the case. Where this involves a deviation from their normal policy institutional investors should be prepared to explain the reasons to their beneficiaries and to the companies concerned.

As a matter of best practice institutional investors should disclose a quarterly or annual summary of their voting activity and, where possible, their full voting records. Voting records should include an indication of whether the votes were cast for or against the recommendations of company management.

The ICGN encourages transparency and consideration should be given to the merit of voluntary public disclosure of an institutional investor's voting record as this may be a way of demonstrating a commitment to accountability and to show that conflicts of interest are being properly managed. As the level of public disclosure has increased in major markets, it is helpful if asset managers explain their thinking on public disclosure even when they have decided not to disclose.

Institutional investors should work proactively with other intermediaries and other relevant parties to remove barriers to voting wherever they occur in the chain, and should seek to assure themselves that their votes flow to the end of the investment chain and are fully reflected in the voting results disclosed by companies. One aspect of this will be appropriately managing any stock-lending activities, in ways which reflect the guidelines in the ICGN's *Securities Lending Code of Best Practice*, including a willingness to recall lent stock ahead of relevant shareholder meetings.

4.5 Participation in relevant policy dialogues

Institutional investors should engage as appropriate in the development of relevant public policy and best practices in order to advance beneficiary or client interests.

Institutional investors can deliver value for beneficiaries and clients by active engagement in public policy or the development of best practice, whether globally or in specific markets or regions. This work can help set the best and most appropriate context for investment activities, it can seek an appropriate economic framework for businesses, and it can assist the management of key risks either for investee companies or for the institutional investors themselves.

Institutional investors should therefore actively consider whether to participate in active public policy discussions relevant to beneficiary or client interests, and should on occasions be willing to press for change where this is deemed helpful to the delivery of value for beneficiaries or clients. Participating in the development of best practice guidance either for the investment chain (or individual elements of it or activities within it) or for underlying investments may also be a key element of delivering on fiduciary duties.

4.6 Collective engagement

Institutional investors should act collectively as appropriate where this would assist in advancing beneficiary or client interests, taking account of relevant legal and regulatory constraints.

Institutional investors should consider working jointly with other investors or investor representative bodies on particular issues. In working with other investors, they will need to respect rules with regard to concert parties.

As part of their work on public policy, institutional investors should encourage regulators to develop rules with regard to both market abuse and acting in concert that can be enforced sensibly and do not inhibit reasonable collaboration between shareholders or constructive dialogue more generally between investors and the entities in which they invest.

5.0 Overview of the investment chain

The investment chain between the ultimate owners of companies - the pension, mutual and insurance funds, and the other forms of collective investment vehicles which aggregate the investments and interests of their underlying beneficiaries, the world's individual savers - and the directors of those companies whose job is to act in shareholders' collective interests is a long and complex one. Indeed, some have suggested that it is too complex and confusing. This section is a brief high level attempt to provide insight into that complexity. In a broader sense also the intent of this Statement of Principles for Institutional Investor Responsibilities is to reduce that complexity and confusion: by noting the importance of institutional investors involving themselves in the oversight of companies in which they invest the hope is that directors will feel more immediately their accountability to their ultimate owners and so will be more likely to act more fully in their collective interests.

5.1 Agents

The agents in the process of investment have different roles and responsibilities. These agents form a chain of investment, which can be complex, depending upon the particular arrangements made. In many cases the chain will include:

5.1.1 The collective investment vehicle

Typically individuals' investments are aggregated through a collective vehicle such as a pension fund or insurance business. This collects assets and manages them on behalf of beneficiaries or clients; its obligation is to preserve and enhance value on their behalf. It is usually

overseen by some form of governing body that is responsible for overseeing the investment process and ensuring that other agents play their role in meeting the institution's objectives.

The governing body may be a board of trustees, directors or a sole individual and beneficiaries may or may not have a role in their appointment, depending upon the type of institution. The responsibilities of the governing body should be consistent with its objectives and its operational and oversight role should be clearly defined. This should involve a clear policy and active management of any conflicts of interest which the governing body faces, and it should be clear to whom the governing body is accountable. Trust-based defined contribution pension schemes model themselves on this approach and so fall within this category.

5.1.2 The asset manager

These are the agents which are responsible for execution of the investment mandate set by the collective investment vehicle. The asset manager may be employed directly by the vehicle or be external and appointed on a contract. There may be a sole asset manager, or a series, for different asset categories or regions. In many cases, fund managers themselves aggregate assets together into collective vehicles, such as mutual funds and contract-based defined contribution pension funds; such collective vehicles will need to consider how appropriately to apply standards such as those set out in the Principles for internal governance in order fully to protect the interests of the underlying beneficiaries.

The governance of the fund management body itself will also be a relevant issue in considering the chain of investment. Fund managers may be publicly listed companies with shareholders and board

of directors. They may be privately owned, or structured as a trust. The relationship between collective investment vehicles and their fund managers, and ways to help ensure that fund managers operate fully in their clients' long-term interests, are considered in the ICGN's *Model Mandate Initiative* document.

5.1.3 Service providers

Service providers support the collective investment vehicle. For example, actuaries determine projected liabilities, and consultants may measure investment performance. Advisers may also be appointed by the collective investment vehicle to assist with execution of the mandate, for example, through the appointment of research, advisory or vote execution services and in some cases representation to companies on behalf of the governing body. In order to gain full value from this process, governing bodies need actively to oversee it and to have relevant skills to challenge and test any proposals or comments made. While governing bodies may delegate certain functions to service providers, they will retain responsibility for the oversight and management of these providers.

5.1.4 Custodians

Custodians are responsible for the safekeeping and maintaining of records of the collective investment vehicle's assets, be these in electronic or paper form. In many cases this will result in their being the legal owner of these assets; in order to reflect the underlying reality of their beneficial ownership, custodians will often need to provide additional transparency or indeed direct assistance to their clients to enable them to carry forward activities such as those outlined in the Principles for external responsibilities and their other investor rights. The custodian may

sub-contract part of its functions, for example, to administrators of nominee accounts. Where this happens, institutional investors have a right to expect that sub-custodians will recognise the rights of beneficial owners and their agents, and that custodians will facilitate this.

Pension fund or other clients' assets should be legally separated from those of the custodian, just as the use of custodial services enables appropriate segregation and protection of client assets overseen by external fund managers. The custodian cannot absolve itself of responsibility by entrusting to a third party all or some of the assets in its safekeeping.

This Statement's Principles for Internal Governance are largely intended to address the governance of the collective investment vehicles. They can also appropriately be applied to the governance of collective vehicles more directly under the oversight of fund managers but which also need some independence of approach in the interests of their beneficiaries; such vehicles would include mutual funds and contract-based defined contribution pension schemes. The boards of certain entities may have different accountabilities, such as to governments or taxpayers or their own shareholders, but this should not detract from their obligations to clients and/or beneficiaries. Those agents working on behalf of the collective investment vehicles, whether they be fund managers, custodians or other service providers, need to be effectively held to account for their delivery of appropriate services, not least those ones relevant to the areas covered in the Principles for External Responsibilities.

5.2 Accountability through the investment chain

Governing bodies should develop clear standards with regards to governance of investee companies and its link to the investment process through its impact on value, and for voting of shares and related issues like stock lending (the ICGN's views on stock lending are set out in our Securities Lending Code of Best Practice). The standards set by governing bodies in these respects should help inform their selection of fund managers and other agents.

Governing bodies should be critical both in the selection of consultants and in evaluating the advice they receive from them, and ensure they receive value for all the fees they pay, including for brokerage commission. Where they or their agents outsource services, they should disclose the name of the provider of the services in question, the nature of the mandate they have been given and procedures for monitoring performance of the provider.

Governing bodies should hold their portfolio managers and other agents employed to account for adhering to the standards set for them. They should develop clear channels for communicating their policies, and their own governance approach and structures, to the beneficiaries, their portfolio managers and the companies in which they invest. They should regularly evaluate and communicate their achievements in meeting these policies.

Asset managers and others in a similar agency position should also develop clear decision-making procedures and policies with regard to the governance of investee companies and for voting of shares held on behalf of clients. Their incentive structures should reflect the interests of

the beneficiaries. Charges incurred on clients' behalf, for example brokerage commissions and payments for research, should be justifiable. Asset managers should encourage brokers and research analysts whose services they use to factor environmental, social and governance considerations into their reports as relevant so that they genuinely include all risks faced by businesses on a holistic basis.

5.3 Voting through the investment chain

All intermediaries in the investment chain have an obligation to facilitate the exercise of ownership rights, including voting rights, by the ultimate owners of the underlying assets, and they should have active mechanisms for understanding what these are. Each party in the chain should pass on with due despatch any exercise of investor rights, whether voting or any other corporate action, to the next party in the investment chain. Votes cast by intermediaries should be cast only in accordance with the wishes of the beneficial owner or its authorised agent.

The parties in the investment chain should cooperate to facilitate improvements in the functioning of communications along the investment chain such that votes and other corporate actions are transmitted as promptly as is possible.

5.4 Disclosure of voting

There is an ongoing debate about the disclosure of voting activities. Some institutional investors argue strongly that the votes they exercise belong to their clients and beneficiaries and that it is only to the clients and beneficiaries that the institutions owe a duty of transparency about their activities. Others see the opportunity to influence the way that others vote and so not only make public disclosures but do so

ahead of voting deadlines, enabling others to follow their lead.

The approach which is beginning to predominate is for public disclosure some time after the fact (often quarterly); this means that the institutional investor is publicly accountable for carrying forward its voting obligations with due care and discipline but does not hinder discussions with companies by disclosing sensitive matters at the time of General Meetings. The ICGN supports such an approach.

6.0 Key concepts and definitions

6.1 Definitions

In this statement the terms ‘institution’ and ‘institutional investor’ are used to refer to professional investors which act on behalf of beneficiaries or clients, such as individual savers or pension fund members. Institutional investors may be collective investment vehicles, which pool the savings of many, or the asset managers to which such collective vehicles or individuals allocate funds. Examples of the former include: pension funds, insurance companies, sovereign wealth funds and mutual funds. The investment arrangements for these institutional shareholders will vary according to type, and local law or regulation.

What characterises institutional investment is a separation of the ultimate beneficiary, for whom the investment is being made and who holds the economic interest, from the agent, which acts on behalf of the beneficiary.

In many cases there are many agents in the investment chain between the ultimate beneficiary and the underlying asset(s) in

which they invest – as discussed above. One aim of internal governance structures and the Principles in this respect is to minimise the frictional costs implicit in the investment chain and help align the agents as fully as possible to the interests of the beneficiaries or clients.

The duty to act solely in the best interests of the beneficiary or client is called in some markets a ‘fiduciary’ duty, which requires prudence, care and loyalty. These duties cannot be delegated, even though the execution of the investment will involve other parties, who are referred to as agents. The ultimate beneficiary is in this context sometimes referred to as the ‘principal’.

6.2 Concepts

Among the concepts considered and referenced in this document are the following. These are complex matters and the brief paragraphs below cannot do full justice to them. Nevertheless, we believe that these brief outlines may be valuable initial insights and may encourage a greater collective understanding of these matters.

6.2.1 Conflicts of interest

Conflicts arise where the interests of an agent are contrary to the interests of their client(s) or beneficiaries, or indeed where the interests of different clients or beneficiaries of an individual agent are different. These situations need to be made fully transparent to the relevant client(s) and indeed how they are handled must also be made appropriately transparent. Especially where the agent is charged with a fiduciary duty, conflicts must be avoided and if unavoidable must be handled so that clearly all actions are taken in the client(s) interests.

All institutional investors need clarity on the personal conflicts which individual members

of their staff or governing bodies may face, and where relevant these individuals should be removed from decision-making in situations where their conflicts arise or may be seen to impinge. To maintain confidence among clients and beneficiaries, it will often be preferable to err on the side of caution in relation to conflicts.

6.2.2 Fiduciary duty

A fiduciary duty arises when an individual is charged with the care or oversight of an asset that belongs to another party. This professional oversight role carries with it high standards of prudence, care and loyalty such that the value of the asset is preserved and increased over the time horizon relevant to the underlying owner of the asset.

Any party charged with a fiduciary duty faces particular obligations to act only in the interests of its beneficiaries; the management of, and preferably the avoidance of conflicts of interest in such situations are of particular importance. There are ongoing considerations in a number of jurisdictions as to the full extent of the application of fiduciary duty across the investment chain.

6.2.3 Intergenerational fairness

Most collective investment vehicles will aggregate the interests of underlying beneficiaries investing over a range of time horizons; in many cases, these differences will not be just a matter of a few years but whole generations. Such generational differences create real challenges for the governing bodies charged with acting in the interests of all beneficiaries. Such challenges cannot simply be ignored but rather need to be managed such that actions now do not damage the long-term interests of those who will only begin to drawdown benefits from the collective

vehicle many years later. There may in some cases be a tendency to focus more on the interests of those drawing benefits already or those who will shortly begin to do so; this tendency must be countered by a consciousness of the need to be fair between the range of generations among the collective vehicle's beneficiaries.

6.2.4 Stewardship

Stewardship means the careful oversight of assets. It is coming to mean the actions of an involved investor in overseeing the performance of companies in which it invests, actions such as those set out in the Principles for external responsibilities. The term is used directly in this sense in the UK Stewardship Code, but it is less well understood elsewhere in the world. It is for this reason that the term is largely avoided in this document; the times when it is used are deliberately to contrast these ongoing ownership activities from investment or trading decisions of whether to buy or sell an investment interest. In circumstances where there is no risk of confusion between these two different forms of ownership decision-making, active ownership may be a term which is more generally understood internationally.

6.2.5 Ultimate risk-bearing in institutional investors

Different forms of collective investment vehicle leave the risk burden on the shoulders of different parties. For example, in defined benefit pension schemes the risk that the assets will not cover the liabilities largely rests with the sponsoring employer; in defined contribution pension schemes, the risk of financial underperformance by the assets rests with the individual beneficiary. Fiduciaries will need to be conscious of the way in which their responsibilities differ given these different risk-bearing structures.

7.0 Annexes

7.1 Acknowledgements

This is the third version of this ICGN statement, building from versions published in 2003 and 2007. The Principles reflect the on-going development in understanding of the investment chain and the obligations of its members. Institutions that comply with these Principles will have both a stronger claim to the trust of their end beneficiaries and to the exercising of investor rights on their behalf. The implementation of these principles will help generate sustainable returns for beneficiaries and help secure a healthy corporate sector. While the application of the principles set out here will vary according to market conditions, including the legal framework, all market participants should aim to enhance their approaches over time, taking the opportunity to learn from best practices wherever in the world they are exercised.

This re-draft of the ICGN's Statement of Principles on Institutional Investor Responsibilities has been developed for the ICGN by:

Working Group members:

Paul Lee (chairman), Rita Benoy Bushon (co-chairman), Stephen Davis, Carol Drake, David Jackson, Niels Lemmers, Charles Macek, Ryoko Ueda, Kerrie Waring.

Committee members:

Other members of the ICGN Shareholder Responsibilities Committee (SHREC):

Erik Breen, Andrew Clearfield, Charles Demoulin, Emily Dellios, Sola Ephraim-Oluwanuga

Peggy Foran, Keith Johnson, Pierre-Henri Leroy, Mike McCauley, Juan Prieto, Chad Spittler, Peter Taylor, Zhengjun Zhang, Harlan Zimmerman.

The working group also wishes to acknowledge the helpful contributions of the following ICGN members and organisations through the consultation phase:

Australian Institute of Superannuation Trustees, Brian Barnier, Canadian Coalition for Good Governance, Comgest, Governance for Owners, JP Morgan, Peter Montagnon, Chad Spittler, John Wilcox, Narita Yumi.

7.2 Contacts

For more information about the work of the ICGN Shareholder Responsibilities Committee, please visit the ICGN website at www.icgn.org or contact the ICGN Secretariat:

By Email: secretariat@icgn.org

By Phone: +44 (0) 207 612 7098

By Post: ICGN Secretariat, 16 Park Crescent, London, W1B 1AH United Kingdom

7.3 ICGN Guidance

ICGN Statement and Guidance on Gender Diversity on Boards (2013)

ICGN Statement of Principles for Institutional Investor Responsibilities (2013)

ICGN Executive Remuneration Principles and Policy Disclosure Guidance (2012)

ICGN Guidance on Political Lobbying and Donations (2012)

ICGN Model Contract Terms Between Asset Owners and Managers (2012)

ICGN Corporate Risk Oversight Guidelines (2010)

ICGN Non-executive Director Remuneration Guidelines (2010)

ICGN Position paper: What Investors Want from Financial Reporting (2010)

ICGN Global Corporate Governance Principles (2009)

ICGN Guidance on Anti-Corruption Practices (2009)

ICGN Statement and Guidance on Non-financial Business Reporting (2008)

ICGN Securities Lending Code of Best Practice (2007)

ISBN 978-1-907387-13-5



9 781907 387135 >

£25.00

16 Park Crescent, London, W1B 1AH, United Kingdom

Phone: +44 (0) 207 612 7098 Fax: +44 (0) 207 612 7085 Email: secretariat@icgn.org Web: www.icgn.org