ICGN
International Corporate Governance Network

ICGN Model Contract Terms Between Asset Owners and Managers

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ICGN Model Mandate Initiative

Model contract terms between asset owners and their fund managers

About ICGN

The ICGN is a global membership organisation of around 550 leaders in corporate governance based in 50 countries with investors collectively representing funds under management of around US$18 trillion. The breadth and expertise of ICGN members from investment, business, the professions and policymaking extends across global capital markets and our mission is to raise standards of corporate governance worldwide. For more information about the ICGN contact the Secretariat by telephone: +44 (0) 207 612 7098, email: secretariat@icgn.org or visit www.icgn.org.

Preamble

Asset owners are increasingly considering how they can more fully align the interests of their fund managers with their own obligations to beneficiaries and participants. The ICGN offers this document and its proposed clauses to assist such asset owners in considering the expectations which they can have of their fund managers and in how they can formulate their contracts, or mandates, with those managers such that they deliver on client expectations. Given the importance of fund manager relationships to successful long-term asset owner performance, these are issues in which many asset owner boards will take a close interest and they may wish to have specific discussions about the contractual terms that they will require of fund managers and of the outcomes of negotiations regarding these clauses.

Key areas of focus for asset owners which are seeking to align the activities of their fund managers more closely with the long-term interests of their beneficiaries are:

- ensuring that the timescales over which investment risk and opportunity are considered match those of the client;
- setting out an appropriate internal risk management framework so that the risks which matter for clients are managed effectively;
- effectively integrating relevant environmental, social and governance factors into investment decision-making and ongoing management;
- aligning interests effectively through fees, pay structures and culture;
- where engagement is delegated to the fund manager, ensuring adherence to the highest standards of stewardship;
- ensuring commission processes and payments which reward appropriate research;
- ensuring that portfolio turnover is appropriate to the mandate, in line with expectations and managed effectively; and
- providing appropriate transparency such that clients can gain confidence about all these issues.

Many asset owners have laid out their approach to these and other related issues in an investment policy statement or similar document. Asset owners will often seek to encourage their fund managers to agree to abide by such statements or otherwise act with full knowledge of them.

Part 1 of this document offers discussion of these areas to help asset owners understand the aims of the contract terms. These issues will necessarily be a matter of negotiation between the parties in the manager selection process and a subject for dialogue and assessment over the life of the fund management relationship. In addition, Part 3 on accountability and reporting, discusses ways in which clients can seek relevant information to hold managers accountable in these areas. The proposed model contract clauses themselves are included in Exhibit A.

The ICGN recognises that there are a significant number of existing and emerging standards, some of them intended to apply across all investment (such as the Principles for Responsible Investment) and others specific to particular asset classes (for example the Institutional Limited Partners Association Principles and the Hedge Fund Standards Board Standards). This document is intended to supplement, not to replace or reproduce, such guidelines and offers clauses to reference them in management agreements as appropriate for a particular asset class.

This document assumes simple direct relationships between asset owners and their fund managers, and does not discuss situations where there are agents subordinate to those agency relationships (such as under fund of funds structures). The intent is that the principles inherent in this document can be taken up and applied by clients into whatever fund management structure they have in place.

The working group responsible for drafting this document recognises that there remains much more work to be done in this area, and would welcome further input as best practice evolves. The ICGN's Shareholder Responsibilities Committee has agreed to consider extending and updating the document two years from its first publication if appropriate. Comments and discussion on the issues raised here would be welcomed by the Committee, via its Co-Chairs, Paul Lee by email at p.lee@hermes.co.uk or Rita Benoy Bushon by email at secretariat@icgn.org.

Note: this Report is prepared for educational purposes only and is not intended as legal advice or an endorsement of specific contract provisions as being applicable in particular cases. Readers are advised to consult with their own legal counsel when considering applicability of the Report's contents to specific contracts, jurisdictions or circumstances.

Contents

1.0 Discussion

This section offers guidance on areas about which clients may wish to enter into active dialogue with existing and potential fund managers to ensure that their interests are aligned and managers focus appropriately on risk factors and opportunities which matter for the long term. The proposed clauses that asset owners are invited to use in discussion and contractual negotiation with their managers to help deliver these objectives are included in the Exhibit at the end of this document.

As long-term owners which are exposed across asset classes, major institutional investors need to be aware of systemic risks to the value of their overall portfolio. Their perspective reaches beyond the risks in any one investment portfolio, either in terms of lifetime or scope, and they need their fund managers to consider not only risks which affect the immediate volatility of their portfolio, but also those which can affect investment value over a longer period or a broader spread of investments. This goes to the core of alignment of interests.

There are three aspects to these risks which matter to the long-term owner: singular long-term risks within individual assets; risks with a combined impact across an asset owner's portfolio; and economic impacts which come to bear across the financial system as a whole or over a long time horizon. Similarly, portfolios with longer-term investment horizons might have opportunities not available to short-term investors, where long-term factors have positive impacts.

A particular focus of the proposed clauses, reflecting increasing thinking among asset owners, is therefore on long-term risk factors which create volatility of returns and can create losses over the long run but which have so far been poorly integrated into investment decision-making. These are now frequently referred to as environmental, social and governance (ESG) factors, though they are also called sustainability, extra-financial or responsible investment indicators, among other terminology. These terms are understood in different ways in different markets; this paper does not address such naming or scope issues. The term ESG factor is used here to mean material and relevant investment risks and opportunities for asset owners with long-term investment horizons. They may have a significant (albeit often difficult to quantify) financial impact over the investment life of the asset owner – though often requiring an intervention to internalise external costs or some other regulatory change before those costs are triggered – and clients are increasingly seeking to build them into the risk management processes and investment decision-making of their managers. Using contract terms such as those offered in Exhibit A may be one tool to assist this happening in practice.

Positive portfolio and systemic effects of ESG factors are also relevant to the design of investment manager mandates. For example, knock-on effects of better company executive remuneration plans or enforcement of integrity standards for company behaviour or financial reporting can influence long-term, risk-adjusted returns at the asset, portfolio and financial system levels.

Just as portfolio performance is now generally adjusted for the risk taken to achieve returns, it is likely that its calculation will also need to take account of the risks which are assumed in these ESG areas, to the extent that these can be identified. That analysis will need to be integrated into the monitoring, evaluation and remuneration of fund management staff.

The areas which are most significant in the relationship between asset owners and their fund managers are discussed below as follows:

1.1 Standards and high-level commitment

Issues to be considered in fund manager contracts

In order for asset owners to know what they are seeking by way of long-term thinking in the investment process, it is helpful for them to agree with their fund managers on a high-level commitment to such thinking. Sometimes this will be in the form of an established statement of commitment from the fund manager; in other cases, asset owners will have established a set of principles to which they expect the investment process will conform. These may be standards developed by an external party or they may be standards specific to the asset owner, often in the form of an investment policy statement or the like. They will best be carried into practice in investment terms if they are incorporated in some way into fund manager contracts; depending on how they are written, this might be done by requiring adherence in some form or requiring the fund manager to be aware of the standards in carrying forward their investments. Asset owners will expect that managers will be able to explain how they have reflected the standards in their investment approach and decision-making.

As well as standards with general application across investments, such as the Principles for Responsible Investment and the CFA Institute's Asset Manager Code of Professional Conduct, there are also sets of standards specific to particular asset classes which asset owners might choose to incorporate in their contracts for relevant mandates. Among these standards are those promulgated by the Hedge Funds Standards Board and the Institutional Limited Partners Association.

One set of high standards which many asset owners will expect of their managers is in the area of the fund managers' own governance. Many will seek reassurance as to the independent oversight of the manager and the effectiveness of its board and other governance structures in holding management to account and in establishing the right risk management approach and wider culture across the organisation, to ensure alignment with, and performance delivery for, clients. Often this is done as part of due diligence and ongoing monitoring.

Proposed subject matters for model terms

- **high-level commitment:** the fund manager undertakes to abide by a high-level set of principles agreed with the client covering a long-term philosophy and approach, and to be accountable for their delivery under this commitment
- **adherence to standards:** requiring adherence to the disclosure standards within the CFA Institute's Asset Manager Code of Professional Conduct or equivalent; and adherence to relevant expectations in other standards
- **integration into investment process:** affirming that the manager has integrated this approach into its investment and risk management processes and will account for adherence to agreed principles on a transparent basis

1.2 Risk management

Issues to be considered in fund manager contracts

Asset owners are only interested in managers which are capable of generating returns on a risk-adjusted basis. Even if risk management was not formerly core to the assessment of fund manager capabilities, events over recent years have demonstrated that no manager which fails to manage the risks inherent in its investment approach will perform effectively for its clients over the long-term. Therefore, clients are increasing their focus on risk management in assessing whether a particular fund manager is the appropriate one for them. This is likely to be a key feature of due diligence before appointing any manager. We suggest that any material written representations about risk management capabilities and practices that are presented during the marketing and due diligence process be attached to and incorporated into the management contract. In addition, many clients will seek to include contract terms on risk management reporting and transparency, along with continuing rights to assess the ongoing risk controls to ensure that the quality of risk management seen during due diligence is maintained and enhanced.

Following the financial crisis, there is also an increasing focus on the risk to asset owners of investment approaches which generate systemic risk and the opportunities from those generating systemic benefits. Asset owners are exposed to financial markets generally and so are unlikely to benefit over the long run from investment strategies which produce returns by generating systemic risks that jeopardise the efficient functioning of a particular market or markets more generally. Asset owners thus have an interest in ensuring that their fund managers help to foster well-functioning markets and do not risk undermining them through their investment approach or actions.

Proposed subject matters for model terms

- **risk management:** ensuring that clients can gain effective insight into the manager's risk management framework to gain assurance as to the breadth of the risks managed and the effectiveness of their management

- **long-term risk management:** aligning the manager and client on time horizon and understanding of what the key risks are to achieving the client's portfolio goals

- **systemic responsibility:** ensuring fund manager support for the integrity of the market place, the specific asset class and relevant investment infrastructure, and requiring disclosure of how this has been effected

1.3 Integration of long-term factors

Issues to be considered in fund manager contracts

The time horizon of most asset owners is considerably longer than that of fund managers. Thus for long-term portfolios, the factors and risks which matter to the asset owner are somewhat different from those typically considered within fund management processes. But as these factors and risks will impact their long-term returns, many asset owners are keen to see more effective integration of these longer-term factors into investment processes.

Proposed subject matters for model terms

- **monitoring ESG factors**: requiring appropriate measurement, monitoring and reporting as a necessary first step to integration, whether using internal staff and systems or by employing external providers
- **due diligence:** permitting due diligence by the client into the processes to deliver on the fund manager's integration and risk management commitments and its approach to them, on an initial and ongoing basis, to ensure these continue to be carried forward properly in practice
- **effective ESG integration:** ensuring that the fund manager establishes and adheres to relevant internal guidelines on how ESG factors are effectively integrated into investment decision-making; setting standards against which the fund manager will report on the effectiveness of this integration

1.4 Stewardship activities

Issues to be considered in fund manager contracts

Asset owners are increasingly considering (not least because of the proliferation of stewardship codes and their equivalents) the value potentially to be gained for long-term investment performance from behaving as an active owner of the assets in which they are invested, whether this is companies held through equity or bond portfolios, or real estate through property or infrastructure mandates. In essence, stewardship is working with the underlying assets to ensure that they focus on delivery of risk-adjusted value over the time horizons that matter to long-term owners and taking into account risks and other issues that matter to long-term owners. Some asset owners hire specialist firms to do this work, but many expect this to be part of the process of fund management. The proposed clauses require managers to put such stewardship responsibilities into effect. Managers will also require clarity of which ownership rights and powers are placed in their hands by clients to be exercised as they choose, and which are only available to be used pursuant to client directions or approval.

In addition, there is a need for clients to have effective oversight of the voting activities carried out by fund managers in their names. Some clients will prefer directly to control the votes attached to their investments, while others would rather require managers to vote according to established guidelines. The latter will need a basis to hold managers to account for delivery in respect of those guidelines. Still others will simply seek to hold their managers to account for the decisions that they take: this will require high levels of relevant transparency.

A further issue which can cause controversy in the area of stewardship is stocklending, under which clients' shares are in effect sold, subject to a buyback right. Often this activity is more under the client's control than the fund manager's, but on occasion the stocklending programme is in the hands of the fund manager. Whichever approach applies, it will be important to ensure that both sides have access to relevant information, which includes current positions and transparency on fees earned. Particularly in order to deliver stewardship responsibilities, both parties will be keen to have insight into which stocks are subject to lending at given times and they may need to agree a basis on which one or either party can trigger a recall of lent stock, either so that it is not potentially in the hands of a party whose interests diverge from those of the client or so that the parties can exercise stewardship rights in full. The ICGN has a key piece of guidance in this area – its Securities Lending Code of Best Practice.

Proposed subject matters for model terms

- **stewardship responsibilities:** requiring the fund manager to adhere to good practice in terms of stewardship and report on its activities; clarifying which ownership rights and powers are in the hands of the fund manager and which retained by the client

- **voting oversight:** requiring that the client can direct the voting of the underlying shares in respect of their investment, or requiring that voting is carried out according to guidelines set by the client and in their interests

- **securities lending:** clarifying which of the parties will have visibility of the level of stocklending and any lent positions at a given time and responsibility for those positions, and which of the parties will have scope to recall lent securities for stewardship purposes

1.5 Long-termism and alignment

Issues to be considered in fund manager contracts

Asset owners seek to encourage their fund managers to act fully in their interests by setting fee structures that appropriately align the interests of fund management firms with their own – and encouraging the fund management firms also to align their remuneration structures and cultures with the long-term perspectives which will generate returns over the time-horizon that asset owners need. This is therefore a crucial area for the proposed best practice clauses.

Performance fees and the relevant hurdle or benchmark for performance will be a matter of individual negotiation between fund managers and clients, and there is perhaps little to add in this area while noting the increasing prevalence of the measurement of fund manager performance over longer periods, the growing acceptance that high water-mark structures are necessary to ensure a proper alignment of interests and the use of clawback structures; however, there is scope for proposed clauses regarding base fees. In order to ensure alignment of interests, many clients take the general view that base fees should be sufficient only to fund the costs of the fund management business and not be a source of profits in their own right. Where this is not the case, fund managers have too little incentive to generate performance and too much simply to gather assets. Thus, in particular for seed-funding investments with smaller fund managers, clients will seek to ensure that the level of base fee will reduce as the fund manager's business expands, such that the cost base (which typically increases much more slowly than any increase in assets under management) is shared fairly between the fund manager's clients. Similar arguments mean that base fees with larger, more established fund managers are more likely to be set in terms of fixed monetary terms rather than in terms of basis points.

Turnover of holdings is a significant indicator of whether fund manager processes are fully aligned with the identified strategy and interests of clients. Significant deviations from turnover expectations can be an indicator of a lack of conviction in investment decisions and momentum-following behaviour, neither of which may be in clients' long-term interests, especially as increases in turnover increase the frictional costs faced by client portfolios and can influence systemic risks. Conversely, unexpectedly low turnover might signal inattention to risk management or a drift towards a more passive investment approach.

Different clients will have different approaches to this issue, but the proposed clauses offer a soft guideline model whereby the client agrees to an expected range of turnover with the fund manager, actual portfolio turnover is disclosed on a regular basis, and any turnover outside the expected range must be explained by the fund manager. The expected turnover range can be altered over time to reflect changes in the mutual expectations of client and manager and varying market conditions.

Clients decide to hire fund managers on the basis of the circumstances at the time of appointment. There can subsequently be certain significant changes (of personnel, ownership or investment process, including the approach to responsible investment) which may affect the assessment of whether maintaining the relationship at the existing level (or at all) is appropriate. Ensuring proper alignment of interests requires that clients be informed promptly of any such changes, and where the changes are truly significant usually that they will be able to alter their investment in some form. Clients also need to remain confident of the ongoing financial viability of the manager.

One barrier to alignment can be conflicts of interest, which may undermine the ability or willingness of fund managers to act clearly in their clients' interests, or may raise challenges when the interests of different clients diverge. Clients need to be confident that managers have appropriate processes to identify, consider and effectively manage any such conflicts of interest. These need to cover cases of firm or staff conflicts with client interests, client/client conflicts of interest, and also any conflicts which arise because of issues between the fund manager and any other entities within its group. Clauses should permit insight into the fund manager framework to consider and manage conflicts, and transparent reporting of how any relevant conflicts have effectively been managed over the prior period.

Proposed subject matters for model terms

- **fees, remuneration and culture:** requiring that fee and remuneration structures appropriately align the interests of the fund management firm and individual fund managers with those of the client and promote the appropriate culture within the fund management firm

- **portfolio turnover:** including an appropriate expected turnover range (subject to a periodic review) and requiring disclosure and discussion when this is breached

- **transparency on developments:** requiring prompt and full disclosure: if the structure of the fund manager, its governance, individual portfolio manager remuneration scheme, investment approach (including responsible investment approach) or risk appetite changes during the mandate period; if there are any sales by key staff of holdings in the fund or the manager; and if there are any regulatory investigations or legal proceedings taken against the manager. For the client to have comfort as to the robust and ongoing viability of the manager, it should also share its management accounts or financial statements on a regular basis

- **conflicts of interest:** managers should have in place an effective conflicts of interest policy; have appropriate mechanisms, training and procedures to ensure that the policy is carried out in practice; and promptly report to clients when it is materially changed or waived

1.6 Commission & counterparties

Issues to be considered in fund manager contracts

One of the key frictional costs which clients face, the value of which is often significantly unclear, is commission. Given the prevalence of practices like soft commission and other possible benefits to fund managers from this cost burden for clients, it is an area where greater transparency is needed so that clients can have full confidence that the costs they are bearing generate commensurate value for them. Clarity of the costs undergone and the benefits gained will be required. Many clients are increasingly interested to understand whether the research which some commission pays for is focused on issues which will generate returns over investment timescales appropriate for them; many long-term owners tend to worry that much research focuses on short-term factors and simply promotes churn in portfolios or generation of long-term risk exposure, which is often not in the interests of an asset owner's beneficiaries. Clients may have a particular wish to understand the costs and the value of commission payments where broker research is integral to the fund manager's delivery of ESG integration or stewardship responsibilities. Many clients may also want mandates to address the allocation of commission payments in a balanced manner that includes development of research aligned with the interests of long-term investors with stewardship obligations and exposure to systemic risks.

Significant value can be lost from portfolios where counterparty risks are not monitored and managed effectively. Clients will wish to understand that this risk is indeed being managed effectively, and some may wish to have clarity of counterparty exposures so that they can aggregate and assess such risks across all of their portfolios.

Proposed subject matters for model terms

- **commission:** requiring that commission payments and structures paid for from client funds are: made solely in client interests; reflect an appropriate balance between short- and long-term client interests; and are transparently disclosed at client request, so that clients can assess the extent to which they assist the delivery of the fund manager's integration and ownership commitments

- **counterparty risk:** requiring that counterparty risks are managed effectively and are transparent to the client

2.0 Accountability and reporting

As important as setting standards within fund management contracts is how clients can effectively call their fund managers to account in respect of these mandates. The intended standards will most effectively be delivered where managers are made accountable on a regular basis for their delivery against them. Exhibit A therefore includes some proposed model contract terms on reporting; this reporting will form the basis for fund manager accountability.

Manager accountability requires that both the fund manager and any relevant custodian provide relevant and regular information flows to enable client insight into delivery of the overall long-term investment aims, including among other things:

- performance on a risk-adjusted basis relative to any benchmark;
- portfolio composition and explanations of significant changes over the period since the last report;
- risk exposures and management;
- the approach to responsible investment and how this is effectively delivered for the portfolio;
- success in achieving overall goals for the client's investors/beneficiaries in a sustainable and impartial manner;
- delivery of voting and stewardship responsibilities according to the mandate;
- level of turnover and explanation if this exceeds expected levels;
- commission payments and counterparty relationships; and
- securities lending positions and activity.

Asset owners will also expect to be kept regularly informed as to the governance structures which ensure independence, alignment and culture at the fund manager, and particularly to be kept informed of any key developments in the governance approach.

By seeking greater transparency and disclosure from their fund managers, clients will increasingly need to consider the interests of their various investor/beneficiary groups and which factors are most crucial to their relationships with managers, as well as what the consequences might be of any failure to deliver against the expectations set in the contract and any associated standards, including the investment policy statement or relevant parts thereof. In order for the asset owners also to be accountable to their investors/beneficiaries, they will need to consider disclosing their policy in relation to best practice contract terms (such as those offered in this document) and the extent to which such clauses are reflected in their contracts with their fund managers.

It is acknowledged that in due course the ICGN or other parties may wish to seek to develop a clear standard set of metrics/KPIs and disclosure standards in relation to the subject areas highlighted in Part 1 of this document and the relevant contract terms proposed in Exhibit A. Such an approach is beyond the current scope of this project. Client requirements for manager transparency in respect of these issues will assist the development of best practice and over time standardised metrics on each of them.

Such disclosure expectations are likely to be developed in the context of active and ongoing engagement between client and manager on the range of relevant issues, with the aim of seeking continually enhanced practice and providing assurance that promises are carried forward in practice.

3.0 Exhibit A: Model Contract Terms

Model contract clauses, including possible alternative clauses, are proposed here – sometimes with an indication of the circumstances under which one alternative may be more appropriate than another. In addition, some additional clauses are recommended for specific circumstances made clear in their description.

An asset owner's ability to negotiate acceptance and wording of these specific clauses is likely to vary between managers, investment vehicles and situations. Not all clauses will be suitable for all contracts, and asset owners may need to consider whether they should seek clauses such as those below in the fund management agreement or within a side letter or the equivalent. Questions of enforceability may be particularly relevant to this consideration.

Proposed model terms for high-level commitment

The Manager acknowledges that it acts as a fiduciary on behalf of the Client and its investors/beneficiaries.

Alternative 1: *In carrying out its duties under this agreement, the Manager will manage the portfolio in accordance with the Client's responsible ownership policy, as attached at Schedule XX and as amended from time to time. The Manager will also manage the portfolio in accordance with the Principles for Responsible Investment, to which the Client is a signatory.*

Alternative 2: *In carrying out its duties under this agreement, the Manager will take cognizance of the Client's responsible ownership policy, as attached at Schedule XX and as amended from time to time. The Manager will also take cognizance of the Principles for Responsible Investment, to which the Client is a signatory.*

The Manager will not make investments which would contravene the Investment Policy Statement/Statement of Investment Principles or would be in contravention of the restrictions on investments referred to in the Regulations governing the Client's authority.

Proposed model terms for adherence to standards

The Manager will, in discharging its obligations under the Agreement, have regard to relevant industry best practice, specifically to the Principles for Responsible Investment and the standards laid out in Schedule YY. The Manager will meet the disclosure requirements of the CFA Institute's Asset Manager Code of Professional Conduct.

Proposed model terms for integration

Alternative 1 [where relations are governed by fiduciary duty]: *The Manager will ensure that its investment processes and individual decisions as relevant reflect the policies and standards set out in Schedules XX and YY. Where the Manager believes that any policies or standards conflict with one another or with the Manager's fiduciary duty to generate investment performance, whether generally or in specific circumstances, the Manager will consult in good faith with the Client as to which policies and standards shall and shall not be applied.*

Alternative 2 [where relations are governed solely by contractual relationship]: *The Manager will ensure that its investment processes and individual decisions as relevant reflect the policies and standards set out in Schedules XX and YY. Where the Manager believes that any policies or standards conflict with one another or with the Manager's aim to generate investment performance, whether generally or in specific circumstances, the Manager will consult in good faith with the Client as to which policies and standards shall and shall not be applied.*

The Manager will have an investment process which incorporates relevant long-term factors such as ESG issues consistent with the Client's responsible investment policy set forth in Schedule XX and will establish relevant guidelines to this end. The Manager will ensure that its staff apply due care and diligence to following this process, ensure staff adhere to these guidelines, and report [at least annually] on implementation.

Proposed model terms for risk management
The Manager acknowledges that the Client is relying on the Manager's representations regarding its risk management capabilities as a material inducement to enter into this contract. The Manager's risk management practices described in Schedule CC, including those relating to ESG and systemic concerns, are incorporated into and made a part of the Manager's ongoing obligations under this Contract.

The Manager will facilitate access by the Client to its staff and systems such that the Client can gain assurance on an ongoing basis that the Manager has appropriate risk management frameworks and processes in place to address impartially the full range of risks which may affect the value of the Portfolio and the interests of the Client's various investors/beneficiaries.

Proposed model terms for investment horizon
The Manager acknowledges that the risks which the Client and its investors/beneficiaries face are not solely related to deviations from market benchmarks. The Manager acknowledges its need to consider long-term and systemic risk factors in order to manage risks which are relevant on the Client's long-term investment horizon and to the Client's fiduciary responsibilities.

Proposed model terms for systemic responsibility
The Manager acknowledges that both it and the Client rely on the integrity of the marketplace to generate returns for the Client's investors/beneficiaries. The Manager will play a positive role in supporting the maintenance of appropriate and fit-for-purpose market regulation and infrastructure and will at least annually report to the Client on its activities in this regard.

The Client may provide written notice to the Manager if substantial activities are undertaken by the Manager or its affiliates which appear to be materially adverse to the interests of the Client and its investors/beneficiaries in maintaining the integrity of the marketplace or fit-for-purpose market regulation and infrastructure ("Adverse Activities"). The Manager shall have at least thirty (30) days to respond in writing. If the Client then determines, in good faith, that the Manager or its affiliates are continuing to engage in Adverse Activities, the Client may terminate this Contract upon written notice and without further cause [under the Termination Provisions].

Proposed model terms for monitoring ESG
The Manager will have a process for monitoring current or potential investments in relation to relevant long-term factors such as ESG concerns. The Manager will ensure that its staff apply due care and diligence to applying this monitoring process, including considering the extent to which such long-term factors generate investment risks or opportunities.

Proposed model terms for ongoing due diligence
The Manager will facilitate access by the Client to its staff and systems such that the Client can gain assurance on an ongoing basis that the Manager is

appropriately implementing the Client's responsible investment policy set forth in Schedule XX, monitoring key long-term risks and integrating such factors into its investment and risk management decision-making.

Proposed model terms for stewardship
The Manager will, in accordance with the policies and standards set out in Schedules XX and YY, engage in such activities as are appropriate in the circumstances to monitor and influence the management of the investee companies/underlying funds/underlying assets, where such activity is considered by the Manager to be likely to enhance the value of such securities or assets and in the best financial interests of the Client.

Additional clause for equities investments: *In so doing, the Manager will adhere to the principles of the ICGN Statement of Principles on Institutional Shareholder Responsibilities/UK Stewardship Code/Eumedion best practices for engaged share-ownership/ Code for Responsible Investing by Institutional Investors in South Africa/ EFAMA Code for External Governance [or local equivalent].*

Additional clause depending on the extent of delegation of stewardship activities to the Manager (language used here is equity-specific but could be easily amended for relevant rights under other asset classes): The Manager is granted authority to carry out the following rights in respect of assets held in the Portfolio: [voting/bringing forward counterproposals/ proposing shareholder resolutions/calling for special audits/attending general meetings/calling an EGM/recovering the proceeds of class actions or other litigation brought by other parties/bringing class actions, derivative actions or other litigation]. An appropriate proportion of the costs of any such exercise of rights will be attributable to the Portfolio. The Client retains the following rights in respect of assets held in the Portfolio: [bringing class actions, derivative actions or other litigation/recovering the proceeds of class actions or other litigation brought by other parties/calling an EGM/attending general meetings/calling for special audits/proposing shareholder resolutions/ bringing forward counterproposals/ voting]. The Manager undertakes to raise with the Client situations in which the exercise of some of these rights might be appropriate, and the parties will agree on an appropriate good faith allocation of any associated costs.

Proposed model terms for voting
Alternative 1 [where Client or its agent has voting control]: *The Manager will enable the Client or its designated agent to direct the exercise of any voting rights attaching to the Portfolio investments.*

Alternative 2 [where Manager votes according to Client guidelines]: *The Manager will procure the exercise of any voting rights attaching to the Portfolio investments in accordance with the Client's expressed voting guidelines, with a view to achieving best practice standards of corporate governance and equity stewardship and with the aim of adding value to, and/or preserving value in, the Portfolio, as well as reducing unwanted risk exposures.*

Alternative 3 [where voting control delegated to Manager]: *The Manager will procure the exercise of all voting rights attached to the Portfolio investments on the Client's behalf, in accordance with the Managers' voting policy and any market-specific guidelines approved by the Client. The Client reserves the right to rescind, upon [one day's] advance written notice, the Manager's authority to make voting* *decisions for specific companies, issues or time periods. The Manager will use best endeavours to facilitate such Client voting decisions to be implemented. The Manager will have in place appropriate policies to manage any conflicts of interest in relation to voting matters and shall report at least quarterly on all votes involving companies where the Manager or an affiliate have a contractual relationship or other material financial interest.*

Proposed model terms for stocklending

Alternative 1 [where lending is to be done by the Manager]: *Save as agreed from time to time between the Manager and the Client, the Manager may enter into arrangements to lend to a third party investments and other assets or documents of title or certificates evidencing title to investments and other assets held in the Portfolio. The Manager agrees to make available to the Client a list of Portfolio investments out on loan at any given time, on the basis laid out in Schedule ZZ. The Manager agrees that the Client or its agent may from time to time provide a list of those investments or assets which shall not be lent or shall promptly be recalled if out on loan. No new loans will be made of these listed investments or assets, and recalls will be triggered as soon as notice is given. The Manager will consider whether it should recommend to the Client that any individual investment or asset, or class of investments or assets, should be excluded from lending activities from time to time to protect the value of the Portfolio, minimise systemic risks or exposure to other risks.*

Alternative 2 [where lending is to be done by the Client or its agent]: *The Manager shall not arrange for any Portfolio investments or documents of title or certificates evidencing title to such investments to be lent to any other person. The Client agrees to make available to the Manager a list of Portfolio investments out on loan at any given time, on the basis laid out in Schedule ZZ. The Client undertakes to consider any recommendation from the Manager that any individual investment or asset, or class of investments or assets, should be excluded from lending activities from time to time to protect the value of the Portfolio.*

Additional clause where lending is done by the Manager: *The Manager shall report at least quarterly on (a) holdings which were recalled for proxy voting, specifying how such votes were cast, and (b) holdings which were on loan and not voted by the Manager on matters involving approval of a merger or acquisition transaction, a contested director election, an executive remuneration issue which received a [20 percent or more] shareholder vote against the company [and (specify other key Client proxy voting issues)].*

Additional clause where lending is done by the Manager: *In carrying out its stocklending activities under this agreement, the Manager will take cognizance of the International Securities Lending Association stock borrowing and lending code of practice and the ICGN Securities Lending Code of Best Practice. This will include but not be limited to the Manager seeking to ensure that its counterparties in any stocklending transaction will not seek to vote the Portfolio securities they have been lent.*

Proposed model terms for fees, remuneration and culture

The Manager will ensure that the pay structures of its staff align their interests appropriately with those of the Client and its investors/beneficiaries, as well as the investment time horizon of the Portfolio. The Manager will disclose how this is done and other efforts it is making to ensure *that its incentive structure is appropriate for generating balanced long-term risk-adjusted investment returns.*

Unless otherwise disclosed in writing, the Manager represents and warrants that at least [50%] of the compensation for each person who exercises investment authority for the Portfolio shall be tied to risk-adjusted Client returns over at least [three] years.

Proposed model terms for portfolio turnover

The expected annual turnover for this investment strategy is expected to range between XX% and YY%, though the Client acknowledges that certain market circumstances and appropriate investment decision-making may lead it to accept a level exceeding this. The Manager will report Portfolio turnover on a quarterly basis and will provide an explanation if turnover is less than XX% or exceeds YY% on an annualised basis over the quarter. The Manager will also provide an explanation if Portfolio turnover is less than XX% or exceeds YY% in a given year. The Manager may ask for a review of the expected turnover level on an annual basis.

Proposed model terms for transparency on developments

Within [one week] of being aware of a relevant event, the Manager will inform the Client of: any regulatory investigation or legal proceedings against the Manager, any of its key staff or the Fund; the departure of any key staff; significant changes in the business structure or ownership of the Manager; material changes to the advisers or service providers to the Manager/Fund, including the auditor, administrator or any custodian or prime broker; if at any time the Client's investment becomes more than 10%, 25% or 50% of the Fund (or such other percentage amount or amounts as the Client shall from time to time specify in written notice); any sales [of more than $10,000 per quarter] by key staff of personal investments in the Fund or any equivalent vehicle managed by the Manager, or any sales of staff shareholdings in the Manager itself; changes to the board structure or membership of any fund structure through which the Client invests; and material changes in investment approach, including but not limited to the responsible investment approach, or risk appetite over the life of the investment.

***Alternative 1 [where the Manager is a public company]:** The Manager will provide the Client with its accounts immediately after they are published.*

***Alternative 2 [where the Manager is a private company]:** The Manager will provide the Client with its management accounts on a quarterly basis.*

Proposed model terms for conflicts of interest

The Manager will establish and maintain a conflicts of interest policy. The current version of this policy is in Schedule AA; the Manager will inform the Client of material amendments to, and waivers of, this policy from time to time, within [one month] of such event. The Manager will ensure that it adheres to this policy such that it effectively identifies and manages conflicts with the Manager's duty to the Client or otherwise entailing a material risk of damage to the interests of the Client or its investors/beneficiaries. Where the Manager does not consider that the arrangements under its conflicts of interest policy are sufficient to manage a particular conflict, it will inform the Client of the nature of the conflict so that the parties can agree how to proceed.

Proposed model terms for commission

The Manager will act in good faith and with due diligence and care [pursuant to its fiduciary duties] in the selection and use of all dealers and brokers appointed pursuant to this IMA and agreeing relevant terms on behalf of the Client. The Manager will actively consider whether any payments made are appropriately in the Client's interests. The Manager's policy regarding its dealing arrangements and choice of brokers is disclosed as Schedule BB. In effecting transactions for the Portfolio, the Manager will at all times comply with this policy, and comply with any applicable obligations regarding best execution under [relevant regulator's] rules. The Manager will also comply with applicable requirements regarding soft commission under [relevant regulator's] rules.

The Manager acknowledges the Client's determination that it is in the interests of the Client's investors/beneficiaries to allocate commission payments towards research on long-term, ESG and systemic investment or risk issues relevant to management of the Portfolio under the Client's responsible investment policy set forth in Schedule XX. The Manager shall ensure that at least [5]% of Portfolio commissions allocated to research are paid to acquire quality research that reflects an enhanced analytics evaluation of long-term, ESG and systemic investment or risk issues. The Manager shall report at least quarterly on research expenditures.

Proposed model terms for counterparties

The Manager will act in good faith and with reasonable skill and care [pursuant to its fiduciary duties] in its choice and use of counterparties in accordance with procedures previously disclosed to the Client. The Manager will monitor its counterparties on an ongoing basis and manage the Portfolio's overall exposure to any one counterparty such that risks of default or failure are appropriately controlled. The Manager will disclose on a [quarterly] basis the range of counterparties used during the quarter, the maximum and average exposures to each counterparty and the existing exposures at the end of the quarter. Such disclosures shall not in any way constitute a waiver of or consent to the Manager's exercise of its obligations.

Proposed model terms for reporting

In addition to reporting requirements set forth elsewhere, the Manager will prepare no later than x business days after the end of the relevant [quarter], reports covering the reporting period, including:

Standards and High Level Commitment

(a) compliance with the policies and standards set out in Schedules XX and YY, including any instances where those policies and standards were set aside in order to achieve investment objectives;

(b) governance structures at the fund manager and an explanation for any non-appliance of relevant best practice standards;

Systemic Risk

c) key actions carried out to support the maintenance of fit-for-purpose regulation and market infrastructure for the Portfolio investments and risk exposures;

Monitoring

(d) the key material ESG concerns associated with Portfolio investments and an explanation how the Manager has sought to identify, monitor and manage them;

Stewardship, voting and stocklending
(e) a brief summary of the reporting period stewardship activities, including evidence of the effectiveness of those activities;

(f) full disclosure of voting activities over the reporting period, including an explanation of any exercises of discretion under the Manager's or Client's voting guidelines and conflicts of interest;

(g) the revenue from stocklending activities, a list of any Portfolio investments excluded from lending activities during the reporting period and management of stocklending proxy voting considerations, including disclosure of any controversial votes where stock on loan was not recalled;

Turnover
(h) the turnover in the portfolio for the reporting period and an explanation if the turnover is outside the expected turnover range for the period;

Developments and conflicts
(i) any changes to governance, ownership or structure of the Manager, or in its investment approach or risk appetite;

(j) any regulatory investigation or legal proceedings against the Manager, any key staff or the Fund,

(k) any changes in staff ownership in the Fund or any equivalent vehicle managed by the Manager or changes in staff ownership in the Manager itself;

(l) regular financial accounts of the Manager, either [if Manager is public] after their publication or [if Manager is private] [quarterly] management accounts

(m) any changes in or waivers of the Manager's conflicts of interest policy, and any additional conflicts which have arisen over the reporting period;

Commission and counterparties
(n) the payments made under the commission policy, highlighting any deviations from the policy; and

(o) the range of counterparties used during the reporting period, the maximum and average exposures to each counterparty and the existing exposures at the end of the reporting period.

Schedules – brief outline of those highlighted in proposed clauses

Schedule XX
The Client's responsible investment policy

Schedule YY
Industry Best Practice standards [examples, to be added to as relevant, and some are only relevant for certain asset classes of investment]

- Financial Stability Board remuneration principles and implementation standards

- Institutional Limited Partners Association Principles

- Hedge Fund Standards Board standards

- Global Real Estate Sustainability Benchmark/Better Buildings Partnership

- International Securities Lending Association stock borrowing and lending code of practice/ICGN Securities Lending Code of Best Practice

- ICGN Statement of Principles on Institutional Shareholder Responsibilities/ UK Stewardship Code/ Eumedion best practices for engaged share-ownership/ Code for Responsible Investing by Institutional Investors in South Africa/

- EFAMA Code for External Governance
- ICGN Global Corporate Governance Principles

Schedule ZZ
Format for Client reporting to Manager, or of Manager reporting to Client, of relevant stock out on loan

Schedule AA
Manager's Conflict of Interest policy

Schedule BB
Manager's policy on choice of counterparties

Schedule CC
Manager's risk management practices

4.0 Annexes

4.1 Acknowledgements

The ICGN Shareholder Responsibilities Committee created a working group in 2010 to develop further best practice in the agreements between asset owners and their fund managers, with the aim of promoting more long-term behaviour in the capital markets and a greater focus on key risks, particularly those currently downplayed in the financial markets.

In January 2011, the working group issued a call for evidence, and is grateful for all the responses received. As a reflection of those responses and also further debate and discussion within the working group and the wider Shareholder Responsibilities Committee, in June 2011 the working group issued a consultation paper. The consultation paper included proposed model clauses representing leading practice globally. The working group is again grateful for the comments received on this consultation paper. The final draft of the document was considered at the ICGN AGM and further debate and discussion have again enhanced the working group's thinking.

The current document is the fruit of this consultative process and the ongoing discussions and debates within the working group and the Shareholder Responsibilities Committee as a whole.

As with all ICGN projects, the members of the working group are acting in a personal capacity. We note our affiliations below solely for reference and interest.

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on behalf of the ICGN's Shareholder Responsibilities Committee.

We acknowledge our particular gratitude to all those additional parties which provided concrete input through the consultation process, including: CFA Institute, Eumedion, the Financial Reporting Council, the National Association of Pension Funds, Northern Ireland Local Government Officers' Superannuation Committee and Sodali.

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Other ICGN Best Practice guidance available:

- 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 Statement of Principles on Institutional Shareholder Responsibilities (2007)
- ICGN Securities Lending Code of Best Practice (2007)

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