

ASSET OWNER TECHNICAL GUIDE

# INVESTMENT MANAGER APPOINTMENT GUIDE: ESG CLAUSES





Developed in collaboration with:

Grant & Eisenhofer

## SAMPLE ESG CLAUSES

The PRI and Grant & Eisenhofer suggest these ESG clauses are incorporated in the legal documentation with investment managers such as IMAs. They are intended to state clearly the importance of environmental, social, and governance (“ESG”) considerations.

These sample ESG clauses emphasise how essential ESG considerations, embodied by the six PRI Principles, are to the asset owner (AO). It is recognised by the AO and the investment manager (IM) that further particularising the PRI Principles in detailed legal wording may not be ideal, since circumstances may differ per jurisdiction and may differ in interpretation, time and from case to case. As such, we provide the following sample clauses that can be negotiated and tailored to those particular circumstances. Regional (mandatory) requirements must be incorporated and industry-specific benchmarks should be incorporated if available. The clauses become legally binding once they are incorporated into an investment management agreement (IMA) that is executed by both parties. Failure to adhere to these clauses may affect the AO’s decision to renew or terminate the IMA, or to reduce the assets under management by the IM.

### GENERAL CONSIDERATIONS

We recommend the AO and the IM be signatories to the PRI and, if they are, during the duration of the IMA both the AO and the IM shall remain signatories to the PRI as those Principles may be amended or revised from time to time by the PRI. Commitment is required from the most senior representatives (C-Suite and/or Board) of the IMA organisation, across the entire investment business. The commitment to the PRI’s Principles should be reflected across the organisation, its actions and its client portfolios.

### 1. Principles of Responsible Investment and ESG Factors

- 1a.** The IM acknowledges that the AO is committed to being a long-term and responsible investor and is a signatory to the PRI and/or agrees with its Principles.
- 1b.** The IM agrees to take into account the six PRI Principles in connection with each Portfolio Investment. Specifically, the IM agrees to integrate financially material ESG factors – which should include climate change, corporate governance and other relevant risks and opportunities – into its investment analysis, decision-making and stewardship policies and practices, including by engaging with management (or equivalent) of the issuers (or equivalent) in which the AO is invested to improve ESG performance.
- 1c.** The IM shall report any obvious breach or serious violation (detailed in the [Monitoring guide](#)) of the six PRI Principles caused by the issuers to the AO as soon as possible. This report should come with a plan to prevent similar serious violations in the future.
- 1d.** The IM understands that (perceived) non-compliance with the Principles is a key risk for the AO from regulatory, political and/or reputational perspectives and can, in severe cases, lead to a breach of the investment management agreement by the IM.
- 1e.** AOs wishing to incorporate the ESG principles into existing agreements should either (1) notify IMs before renewing if the renewal date is approaching, or (2) negotiate an amendment or side agreement to a longer-term agreement.

### 2. Exclusion Lists

Where the AO has provided an Exclusion List, the IM shall not invest on behalf of the AO in any listed equity or listed fixed income and/or legal entity listed on the AO’s Exclusion List. This list may be changed at the AO’s discretion. In the event of the Exclusion List supplied by AO conflicting with exclusions suggested by IM or a data provider engaged by IM, the exclusions specified by AO shall control.

### 3. ESG Considerations and Appointment of the IM

The AO and the IM recognise that the IM's commitment to ESG considerations and the IM's readiness to implement these in its entire investment process are essential to the IM having been selected and appointed as the IM for the AO.

### 4. Communication and Reporting During Pendency of the IMA

**4a.** As of the commencement date and throughout the duration of the IMA, the AO and the IM will engage in meaningful dialogue in furtherance of the ESG objectives embodied by the Principles. This dialogue will be regular and senior representatives of each institution will participate. The AO and the IM shall inform each other proactively about any development in the portfolio which may materially impact (non) compliance with ESG considerations as embodied in the six Principles.

**4b.** The IM will commit to having a single named individual as the key point of contact with regards to the implementation of the commitments expressed herein. The IM will commit to informing the AO of any changes in the contact information or identity of this individual in a timely fashion.

**4c.** As further specified in detail in the [Monitoring Guide](#), the IM shall regularly report in writing about ESG considerations relating to the IMA. The format, interval and contents shall be discussed in the dialogue referred to in the preceding paragraph. Items to be discussed include, inter alia: a) the (mutual) use of (the same) ESG data supplier, b) the possible use of ESG benchmarks, and c) the use of scorecards. The IM shall explore the integration of key performance indicators into the measurement of performance against the requirements laid out in the AO's policy. Reporting topics that should be covered are outlined in the monitoring guide.

**4d. (i)** In the event AO's assets are held in a segregated account and voting rights continue to be with the AO, IM shall provide ballots and vote recommendations [X] days ahead of the date for voting.

**(ii)** If the AO participates in a pooled vehicle and/or the AO does not own the voting rights, IM shall report on how it voted and, if deemed required by AO, clarify its reasoning. (See also point 6b, *infra*.)

### 5. Violations and Remedies

In the event of any serious violations by the issuer, the IM shall inform the AO immediately. The AO and the IM recognise that any assessment of whether a violation by the issuer is "serious" is subjective by its very nature. In cases of doubt, the IM shall contact the AO to discuss whether the AO considers the violation "serious". In case of serious violations by an issuer, the IM shall proactively inform the AO about possible remedies, which may include [divestiture, engagement, litigation or some combination thereof](#).

### 6. Engagement Practices and Results

**6a.** Depending on the assets within the portfolio, the manager will commit to meet the standards, guidelines or principles outlined in the appropriate local stewardship principles.<sup>1</sup>

**6b.** Reporting to the AO should also include clear and structured reporting on the AO's [active stewardship programme](#). These should include:

- Proxy voting decisions for the previous 12 months, with rationale provided for controversial votes on material holdings as defined by the IM and agreed with the AO; and
- A structured report that outlines the purpose of key individual or collaborative engagement programmes undertaken by the IM on or with assets held within the portfolio. Where feasible, this should cover the impact and intended next actions.

<sup>1</sup> PRI (2019) [Responsible investment regulation map](#)

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**The following suggested clauses cover additional ESG issues that the PRI recommends be considered in legal documentation with investment managers.**

### **7. Stock Lending**

Where the AO and the IM have agreed stock lending is an acceptable activity for portfolio assets, the IM will agree to publish a clear policy on stock lending which aligns with any specific policy adopted by the AO or meets and exceeds the [ICGN Stock Lending Code of Best Practice](#).

### **8. Alignment of Interests**

To align the interests of the IM and the AO, the IM will ensure that the individual, or group of individuals, who have direct control over decisions made on assets within the portfolio or portfolio construction are aligned with the mandate's objectives and that any potential conflicts of interests with other mandates, managed by the same individual or group of individuals, are reviewed and monitored by internal risk and compliance teams.

### **9. PRI Active Ownership 2.0**

Alongside the IM's commitment to the PRI's Principle 2, it will commit to engage with underlying portfolio assets using a process and principles that are aligned with the three elements in the PRI's Active Ownership 2.0: collaborative action, a commitment to outcomes rather than processes and a commitment to support common goals.<sup>2</sup>

### **10. TCFD and Climate Scenario Analysis**

The IM will commit to the [Final Recommendations of the Task Force for Climate-related Financial Disclosures](#) to provide the AO with a clear and comparable overview of how the investment process incorporates climate-related risks. This should, as outlined in the guidelines, include reporting on governance, strategy, risk management and metrics and targets.

### **11. EU Taxonomy**

The AO expects any IM which manages segregated or pooled European funds to disclose against the [EU Taxonomy](#) or have a clear public statement about how it intends to take steps to review and introduce these guidelines and taxonomy.

### **12. Human Rights**

The IM has a responsibility to respect human rights as defined in the OECD Guidelines for Multinational Enterprises (see specific guidance on responsible business conduct for institutional investors) and the UN Guiding Principles on Business and Human Rights. The IM should 1) publicly state its support for these international standards 2) engage with investees about their management of human rights issues and 3) outline to clients issues identified and actions taken – through engagement with investees or policy makers – to prevent or mitigate negative outcomes.

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<sup>2</sup> PRI (2019) [Active Ownership 2.0: the evolution stewardship urgently needs](#)

#### **Disclaimer**

This document is not legal advice and should not be relied upon as such. Neither the PRI Association nor Grant & Eisenhofer P.A. ("G&E"), nor any of their respective agents, partners or employees, takes any responsibility for any action taken or not taken on the basis of anything contained in this document. Specific legal advice should always be sought. This document is deliberately abbreviated and summary in nature.

Any recommendations, actions or the lack thereof made by the PRI Association or any other organisation based on the content of this document should not be taken to have been endorsed by G&E.

# GLOSSARY

- **Asset owner (AO):** An organisation that manages or controls investment funds, either on its own account or on behalf of others, and which owns more than half of such investment funds.
- **ESG integration:** Explicitly and systematically including ESG issues in investment analysis and decisions, to better manage risks and improve returns.
- **Investment manager (IM):** An organisation that manages or controls investment funds, either on its own account or on behalf of others, and which does not own more than half of such investment funds. Also sometimes known as an asset manager.
- **Investment management agreement (IMA):** Contractually binding terms in the relationship between an asset owner and an investment manager.
- **Parties:** Signatories to an investment management agreement, i.e., the asset owner and the investment manager.
- **Responsible investment:** A strategy and practice to incorporate ESG factors in investment decisions and active ownership.

## The Principles for Responsible Investment (PRI)

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

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

More information: [www.unpri.org](http://www.unpri.org)



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

### United Nations Environment Programme Finance Initiative (UNEP FI)

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

More information: [www.unepfi.org](http://www.unepfi.org)



### United Nations Global Compact

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

More information: [www.unglobalcompact.org](http://www.unglobalcompact.org)

