

Advisory Council Chair Cover Note - Proposed PRI Governance Structure

At the 2014 Signatory General Meeting (SGM) in Montreal on 24 September I outlined the proposed changes to the PRI governance structure.ⁱ This followed extensive consideration by the PRI Advisory Council of the recommendations of the independent consultant, Carnstone Partners, drawing on feedback from signatories during the consultation.ⁱⁱ This note summarises the Advisory Council's final proposals and next steps.

The aim of this review is to assess what governance structure the PRI should adopt to best facilitate the fulfilment of its Mission. In doing so, we must balance the interests of different signatories and ensure that decision making processes about the PRI's mission, direction, strategy, finances and operations are transparent, accountable to signatories, efficient and fit-for-purpose. The governance structure and processes determine – internally and externally – how effectively the organisation operates, and how it serves the needs of signatories and stakeholders.

The level and quality of engagement in the governance review consultation process was encouraging, with signatories from every region of the globe providing feedback on the July 2014 initial report from Carnstone, either through in-person meetings, workshops, webinars, or the online questionnaire.ⁱⁱⁱ The feedback has been constructive and positive. The main areas where signatories provided constructive criticism were the rights of signatories and the delegation of authority from signatories to the Board. Some signatories had lost trust in the PRI's governance and it is critical that the new PRI governance model has mechanisms in place to encourage a structured dialogue with the Board, keep the Board accountable and ensure transparency of decision-making, for the future success of the initiative. Strengthened signatory rights, detailed in recommendation seven, are amendments to the preliminary proposals set out in July to better incorporate the feedback we received. I am now confident that the PRI is proposing a governance structure that is fit-for-purpose for the organisation as it stands now, with 1,270 signatories, and for the future as it continues to grow and work towards facilitating its Mission.

Final proposals

Recommendation 1: Single Governing Body

The dual Advisory Council / Board structure is merged into a single governing body, the PRI Board.

In 2010, the PRI made changes to its legal structure and incorporated the PRI Association as a not-for-profit company limited by guarantee under UK law. The process of incorporation required changes to be made to the PRI's governing body and the establishment of a new Constitution.

The ultimate result was a complex governance structure made up of an asset owner-majority Advisory Council directly elected by signatories, an Association composed of the asset owner members of the Advisory Council, and an Association-appointed fiduciary Board of Directors. The

current structure reflects the PRI as it was in 2010, in an initial growth phase with far fewer signatories and a newly established management team. Today the organisation is very different. With 1,270 signatories and a more experienced management team, signatories have asked for greater clarity, simplicity and transparency in the governance of the PRI.

There has been strong support for this recommendation – a single Board responsible for strategy, governance and oversight of the initiative that is elected by signatories. For reasons of clarity, simplicity, accountability and transparency, one Board is the right solution to lead the initiative going forward.

The new Board needs to be effective and one important component of effectiveness is size. Many signatories agreed that a 16-person Board was too large to provide effective leadership and decision-making. The final Advisory Council proposal is for a 13-person Board comprised of:

- *7 asset owners;*
- *2 investment managers;*
- *1 service provider;*
- *2 UN partners (non-voting permanent advisors); and*
- *1 independent Chair.*

The new Board size balances manageability and an allowance for diversity and broad representation, with a clear asset owner majority and some non-asset owner representation.

It is crucial that the new Board has the right mix of relevant skills, competence and diversity of perspectives, which may include diversity of geographical origin, language, culture and gender. To promote diversity the Advisory Council did debate, at length, the appropriateness of the Nominations committee recommended by Carnstone. The Advisory Council concluded that an *external* Nominations committee, constructed of non-Board Directors, would add unnecessary complexity by creating another governance body with control over the composition of the new Board and potentially create issues over its own selection, composition and accountability. Unlike in many equity markets where some dominant institutional shareholders form a natural core of a nomination committee for corporate boards, the PRI has members of equal standing and equal rights within each signatory category. In this situation, the Advisory Council thought the risk of creating a body with little legitimacy in the broader membership of the PRI outweighed potential benefits. An *internal* Nominations committee was also considered, but this could create the perception that the Board was promoting from within itself or established networks. The final proposal is not to transfer the responsibility of the composition of the new Board to a committee but to instead retain the essential signatory right to nominate and vote directly for the best available candidates, with adequate information at hand and taking into consideration their skills and expertise.

Many signatories expressed a concern that the current fixed positions, set according to geographic regions, was too restrictive. The new Board will aspire to maintain geographic, gender and cultural diversity, and fixed positions have contributed to this in the past. On the other hand, the rigidities of the present system can stifle healthy competition for positions. We will work further on alternative ways to promote diversity. The Chair, elected Board Directors, UN partners and Executive, as well as signatories themselves, all have to work to widen the pool of candidates

before each election. The current Election Oversight Committee has a remit to promote diversity on the Advisory Council and this role could be continued in future with the new Board, for example, by initiating a specific search process in relation to particular skills or diversity gaps on the Board. The specific measures to promote diversity will be detailed at a later date, and we welcome input and suggestions from signatories on this issue. To the extent that they require amendments to the Articles, they will be included in the proposals the PRI will put to a signatory vote in late 2014, as described below.

Signatory feedback on the number of terms for Board Directors was balanced. The final proposal is for Board Directors to serve for a maximum of three consecutive three year terms, rather than the two terms recommended by Carnstone. The term limit serves as a backstop; the power to refresh the Board or maintain continuity on the Board is the responsibility and decision of the voting signatories.

Recommendation 2: Advisory role of the UN

The UNGC and UNEP FI will continue to serve on the PRI Board as advisors on a permanent basis.

In early 2005, the then UN Secretary-General, Kofi Annan, invited a group of the world's largest institutional investors to join a process to develop the Principles for Responsible Investment. The UN partnership remains integral to the success and Mission of the PRI.

Both UN partner organisations, UNEP FI and UNGC, remain committed to the PRI and its Mission. It is important that the UN partners are active in the strategic direction and policies of the PRI. For legal reasons, the UN partners cannot be Directors on a fiduciary Board and the proposal of two UN representatives serving on the PRI Board as advisors, without a vote, is a positive solution welcomed by the PRI and the UN partners.

Signatories perceive that the UN partners have not been active in the PRI. Since the inception of the Advisory Council, it was considered important to have formal, high-level UN representation to raise the PRI's profile and legitimacy within the UN and externally. In practice, the UN partners have been represented actively and regularly by the Director of UNEP FI and Deputy Director of UNGC. These two positions will now become the two UN permanent advisors to the PRI. Attendance and commitment expectations for UN partners will be identical as for Board Directors.

Feedback from signatories echoed the importance of the UN partnership to the PRI, but also uncertainty about a lack of clarity on the PRI/UN partnership at the strategic level. The 2015-2018 strategy deepens current UN partner work programmes and identifies five priority collaborative projects that will utilise the strengths of the PRI, UNEP FI and UNGC.

Recommendation 3: Independent Chair

The Chair will not represent any of the signatory groups and will be an independent position.

The independent Chair role, to serve as a broker between parties, was supported by signatory feedback. Areas of discussion within the feedback centred on the nomination, confirmation and removal process for the Chair, and the specifics of the role itself.

The final proposal is for an independent Chair (not an Executive Chair), nominated by the Board and confirmed by signatories. In this way, the Chair will have a direct mandate from the signatories. The Chair is a Director of the Company, has a fiduciary role and therefore a normal vote. To bind the Chair to a casting vote, as Carnstone proposed, would in the view of the Advisory Council be inconsistent with the fiduciary responsibility.

The Board and Executive can best judge the experience, time and capacity required for the role, which will no doubt evolve with the organisation. The Chair's performance will be reviewed annually as part of the structured Board evaluation process. The procedure for removing the Chair is covered in recommendation seven.

The role of lead Director proposed by Carnstone received a mixed response. The view of the Advisory Council is that a lead Director or vice Chair role adds unnecessary complexity. There will be a process in place to raise issues about the Chair and other Directors through a specific committee Chair, and these details will be decided and disclosed in early 2015.

Recommendation 4: Fewer committees

PRI Board committees should be formed to facilitate governance and fiduciary responsibilities. They should be kept to a minimum and the seats will be restricted to Board Directors and UN advisors.

This recommendation is uncontroversial and was welcomed by signatories. In the Advisory Council discussions it was increasingly clear that the important issue was not the number of committees, but the role of committees. Well-functioning committees are crucial to the effective working of the Board and facilitate governance, strategic and oversight responsibilities.

As I underlined in the July 2014 Chair cover note, the Board should decide whether to change or amend committees as it deems necessary, to facilitate the effectiveness of its role and duties.^{iv} Only Board Directors and UN advisors will serve on committees. The primary function of committees in the new structure will be to facilitate the discussions of the Board – not to take decisions on behalf of the Board. The proposed Board is carefully balanced and its composition is difficult to replicate on every committee. Therefore, the Board as a whole, rather than the committees, has to be responsible and accountable for the decisions taken. Work undertaken by committees each year will be reported in the SGM papers.

The number, remit, any delegated powers (in the minority of cases) and terms of reference of each Board committee will be decided upon by the new Board after 1 April 2015, and reported to signatories at the next SGM in September 2015.

Recommendation 5: Unambiguous control

All Board Directors, the elected Directors and the Chair, will be the sole 'Members' of the Company.

The current complex governance structure made up of an asset owner-majority Advisory Council directly elected by signatories, an Association composed of the asset owner representatives of the Advisory Council ('Members' of the Company) and an Association-appointed fiduciary Board

of Directors can be difficult to understand and complicate the decision making process.

For reasons of clarity and accountability, all elected Board Directors plus the Chair will be the sole 'Members' of the Company. All Directors act as individuals in a fiduciary role, are elected by one signatory category, and represent the best interests of all the signatories, the totality of the PRI initiative, advancing the Principles and PRI mission. The UN advisors, as they are not Directors, will not be Members and will not have a vote on the Board. Signatories agreed that this is a sensible proposal.

The proposed Board has a clear asset owner voting majority, with seven asset owner Board Directors, three non-asset owner Directors and one independent Chair Director, retaining the asset owner led focus of the PRI.

Recommendation 6: Clear responsibilities

Clear expectations, terms of reference, lines of accountability, and delegated authorities should be defined and published for the Chair, Board Directors, committees and the Managing Director.

Signatories agreed that clarity of role and purpose is crucial. Defined roles, oversight and delegation of authorities between all layers of the organisation will be developed for adoption at the first in-person meeting of the Board scheduled for June 2015 and will be reported to signatories at the SGM in September 2015.

Recommendation 7: Signatory involvement in governance

Signatories will have certain matters reserved for their endorsement.

The PRI has a growing signatory base and as such needs to be clear and transparent about how signatories can drive strategy, be involved in governance and delegate authority to the Board.

There was a mixed response to the initial recommendations for signatory involvement in governance and the Advisory Council has considered the feedback. The revised proposals aim to balance real delegation from signatories to the Board and its fiduciary role, with accountability and effective mechanisms for signatories to escalate critical issues and influence the strategic direction of the PRI. The proposals replicate, as far as appropriate for the PRI, good corporate governance practice.

Matters reserved for signatories:

- Approval of changes to the Articles, Principles or PRI's mission;
- Board elections;
- Vote on financial accounts and Annual Report;
- Appointment of auditors;
- Approval of the SGM minutes; and
- Confirmation of the Chair.

Binding signatory vote on extraordinary elections

A binding proposal, to compel an extraordinary election of all elected Board Directors, is the

ultimate 'nuclear option' for a signatory base dissatisfied with the Board's performance. The end result is the same as proposed by Carnstone - the provision of the capacity to *not* confirm the Board - but without the requirement for caretaker provisions that could lead to a lack of clarity of roles in the interim. Voting thresholds and majorities required for the respective approvals, votes and binding resolutions will be codified in the revised Articles.

For signatory vote – non-binding resolutions:

Resolutions that attract 3% support of a signatory category will be put to a vote. The proposal is a reduction in the threshold for signatory resolutions from the current 10% and below Carnstone's recommendation of 5%. The thresholds for considering a resolution passed will be codified in the Articles.

The response to non-binding resolutions raised and passed by signatories will be on a '*comply or explain*' basis, formalised with a written response by the Board and disclosed in the SGM papers, detailing the Board's discussion and decision taken.

For formal signatory consultation:

- Material changes to the governance structure;
- PRI strategic plan; and
- Significant changes to the PRI's fee structure.

We also propose the establishment of a *formal signatory consultation process*. This will be codified in the Articles and include a requirement to publish a consultation document; no less than a four week consultation period with multiple channels to provide feedback; and a formal response document with the feedback and reasons for the decisions taken.

Detailing the resolutions process and formal consultation process is an attempt to encourage conversation between signatories and the Board, building trust, while also allowing signatories escalation measures if the response is inadequate. At the same time, it is important that the governance system gives sufficient delegation from signatories to the Board to allow for efficient decision making, reflecting the increasing size of the signatory base. The Board will have fiduciary responsibility for the PRI Association and must have the necessary means to fill this role.

Recommendation 8: Board member continuity

Board Directors should provide continuity in governing the PRI and be accountable to signatories. The role of alternates will be removed.

Signatories strongly supported committed Board Directors, accountable to signatories and the disclosure of attendance at meetings. The role of alternates will be removed as per the recommendation. All Board Directors will be expected to attend every *in-person* Board meeting. For those instances where it is physically impossible to attend the PRI will facilitate audio / video conferencing or a proxy voting mechanism.

Attendance requirements and voting procedures will be detailed in the terms of reference and Articles respectively.

Recommendation 9: Skill levels of the Board

The current eligibility requirement for the PRI Board, i.e. those holding current CEO / CIO / Board Director / trustee positions, will be extended to include retired or ex- CEOs / CIOs / Directors / trustees

The Board is responsible for effective governance, setting the strategy and maintaining oversight of the initiative. Some signatories questioned whether the qualification requirements could be relaxed to encourage a wider pool of candidates to nominate for a position on the Board. However, the Advisory Council believed that candidates for contested positions have been of high calibre and from a multitude of respected signatory organisations. The judgement is that the CEO / CIO / Board Director / trustee position requirement is still desirable to guide the success of the initiative and that it is important to have that high level, C-suite engagement and champions to mainstream responsible investment. The 'C-suite' requirement will be kept under review and as previously stated, the Chair, Board Directors, UN partners and Executive, as well as the signatories themselves, all have to work to widen the pool of candidates before the election process.

Signatories generally agreed that extending the eligibility to include retired or ex-CEOs / CIOs / Directors / trustees was a positive solution to broaden the pool of high quality candidates. As recommended the eligibility requirements will be codified. Retired or ex-officials must be nominated and supported by a signatory, and seconded by another signatory of the same category. Most importantly, it is for signatories within that category to decide to elect the individual or not, based on the skills and expertise the candidate could contribute to the Board.

Recommendation 10: formal Board reviews

The Board will carry out a formal review process on an annual basis, evaluating both Board function, committee function and individual Director performance.

For the proposed structure to work the new Board and committees must work effectively. Signatory perception of the current structure is that the Advisory Council is not effective in leading the organisation, which might have been addressed earlier by more formal and regular reviews.

Signatories agreed strongly with the recommendation that the Board should carry out a formal review process on an annual basis, evaluating Board function, committee function and individual Director performance, but differed on the responsibility for the evaluation, the resources to be allocated and disclosure of the outcomes of the review process.

The proposal is for an annual review of Board performance by self-assessment, with an external review every 2-4 years. Carnstone's recommendation for a review every three years is too rigid, external and internal factors may demand a formal Board review sooner or later. The Chair will report annually on Board performance in the SGM papers.

Next steps

With signatory approval, the new governance structure will commence on 1 April 2015. In mid-December 2014, all signatories will receive detailed information on the proposed governance

structure and invited to vote on the changes by 30 January 2015. Included within this pack will be:

- Proposed revised draft Articles of Association and Administrative Rules; and
- A high level transition plan, with a commitment to undertake any approved changes within a certain time frame.

All signatories will have the opportunity to vote on the proposed governance structure. Under the current rules, any changes to PRI Association's Articles and / or the Administrative Rules relating to the Advisory Council and signatories require the support of asset owner-elected Advisory Council representatives and asset owner signatories.

While asset owner signatories within the current rules have the formal voting rights, as part of the implementation phase, the PRI will also gather in a structured way the votes and opinion of non-asset owners. If a majority of non-asset owners express significant discontent with the proposed revisions, the PRI will consider these and seek to address, within reason, any concerns.^v

ⁱ For signatories that could not attend the SGM a recording is available [here](#).

ⁱⁱ [PRI Governance Review – Carnstone Final Recommendations following Consultation Feedback](#)

ⁱⁱⁱ [PRI Governance Review – Recommendations](#)

^{iv} [July 2014 Advisory Council Chair cover note](#)

^v PRI Association's Articles of Association may only be amended by a special resolution of PRI Association's members (being the asset owner members of the Advisory Council and the Chair of the Advisory Council), as required by the UK Companies Act 2006, and subject to fulfilment of the additional conditions imposed by Article 42.1 of the Articles, if applicable, as mentioned in the next sub-paragraph.

By virtue of Article 42.1, changes to the Articles affecting the composition of the Advisory Council (Article 23.3) and the Principles (as set out in the Schedule to the Articles) may only be made (i) with the consent of a simple majority of signatories who are asset owners voting on the amendment in question, such consent to be given by way of an electronic poll held in accordance with the rules and byelaws made pursuant to Article 41, and (ii) in accordance with any other requirements specified in those rules and byelaws.

The Administrative Rules Relating to the Advisory Council and signatories may only be amended (i) by a special resolution of the PRI Association members, or (ii) by a resolution of the Advisory Council passed by a majority of the asset owner elected members, the Chair of the Advisory Council and the UN members of the Advisory Council, taken together as one group. (Article 41.2 of the Articles and Rule 9 of the Administrative Rules.)