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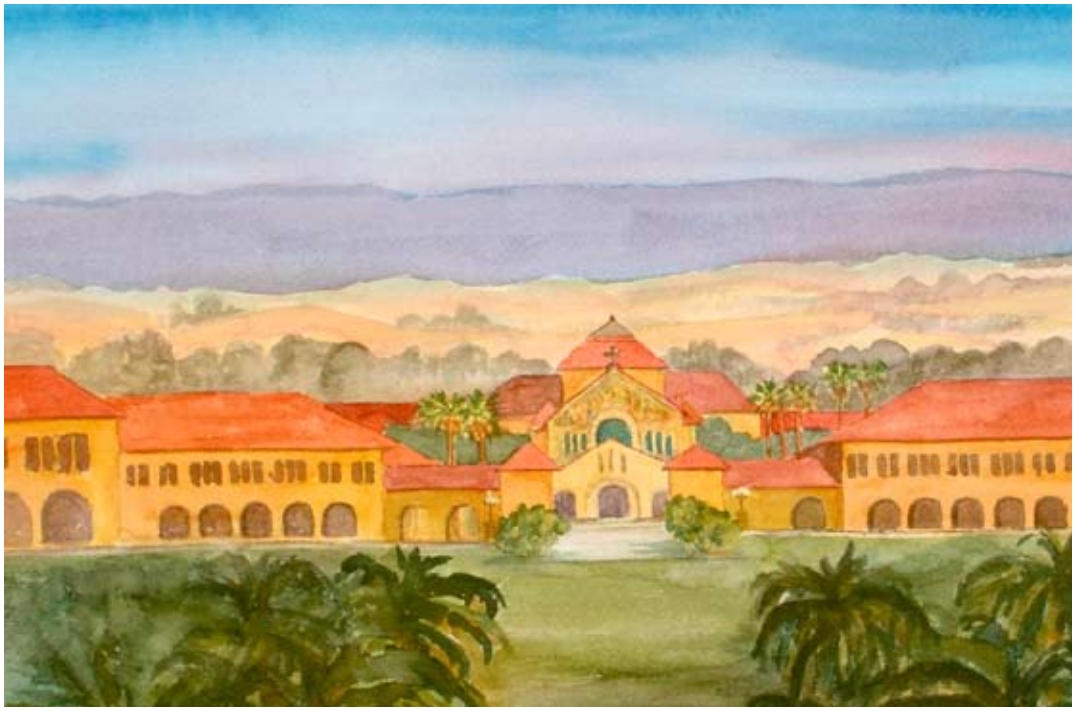
The Stanford Institutional Investors' Forum



Committee on Fund Governance
Best Practice Principles

Peter Clapman, Chair
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In cooperation with:

Stanford Law School
Stanford Program in
Law, Economics & Business

The Rock Center
for Corporate Governance
Stanford University

Stanford Law School
Fiduciary College

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The principles detailed in this report reflect the collective view of the Committee. As the collective work of several individuals, not every member necessarily subscribes with every principle or specific recommendation but each can still support the general propositions of the report as a whole.

Introduction

GOOD organizational governance is critical to publicly owned corporations (where it is known as "corporate governance") and also to the institutional investment funds that own their stocks (where it is referred to as "fund governance") because good governance helps to ensure better organizational performance, fewer conflicts of interest, higher probability that goals and objectives will be attained, and less opportunity for misuse of corporate or fund assets.

Over the past several years institutional investors have successfully encouraged publicly owned companies to adopt and follow a multitude of corporate governance practices. However, they have not always been as vigilant in applying governance best practices to the funds for which they are responsible. Fund governance best practices can provide greater transparency to the governance of institutional investors and help fund trustees and other fund fiduciaries fulfill their responsibility to act solely on the behalf of the fund's beneficiaries, eschewing policies motivated by political, social, or other alternative rationales that are inconsistent with the savings and benefit provision objectives whose purpose is the heart of the fund's existence.

Although institutional investors consist of several discrete organizations (including pension funds, charitable foundations, insurance funds, mutual funds, endowments, and hedge funds), the Committee chose to focus primarily on pension, endowment, and charitable funds. The rationale is simple: first, our experience is for the most part with these three types of funds. Second, there has been a recent series of disconcerting failures in the governance of pension, endowment, and foundation funds.[1] Third, these not for-profit funds also tend to have longer-term investment horizons than other institutional investors which drive, in large part, their campaigns for better corporate governance but also make them vulnerable to inappropriate use of fund assets when they fail to implement fund governance best practices. Fourth, other institutional investors, including mutual funds and insurance companies, generally operate under several existing regulatory regimes that do or can separately address many of the issues raised here[2]. Lastly, funds' and insurance companies' for-profit structures provide substantial marketplace controls on their activities that are to a great extent absent from their non-profit cousins.

Despite their differences, they have one defining characteristic: they are collective pools of wealth managed for the beneficiary interest of others. They represent the combined savings of teachers, churches, union members, public servants, airline pilots, non-profits, colleges and universities, small business owners, firemen, police, and philanthropists. Institutional funds have largely replaced wealthy individuals and families as the majority shareholder of America's corporations. In 2005, institutional investors owned 67.9 percent of the largest one thousand U.S. public companies.[3] The shift from individual to institutional investor ownership of corporate America has resulted in a profound transformation in the relations between shareholder and corporate director and between corporate director and chief executive officer.[4]

Traditional pension funds are at the forefront of this ownership transformation and have led the charge to reform corporate governance among publicly owned companies and thus, receive the main focus of the Committee's attention. The 140

1 E.g., The Getty Foundation, San Diego City Employees' Retirement System, Illinois Teachers' Retirement System, etc.

2 E.g., the Investment Company Act of 1940, the McCarran-Ferguson Act of 1945 and applicable state law.

3 The Conference Board (January 22, 2007). "U.S. Institutional Investors Continue to Boost Ownership of U.S. Corporations." Press Release. http://www.conference-board.org

4 For more information on the growing influence of institutional shareholders, see, inter alia, Davis, Stephen et al., "The New Capitalists", Harvard Business School Press, 2006; Charkham, Jonathan and Ann Simpson, "Fair Shares: The Future of Shareholder Power and Responsibility", New York: Oxford University Press, 1999; Hawley, James P. and Andrew T. Williams "The Rise of Fiduciary Capitalism: How Institutional Investors Can Make Corporate Governance More Democratic", Philadelphia: University of Pennsylvania Press, 2000; and Drucker, Peter F. "The Unseen Revolution: How Pension Fund Socialism Came to America", New York: Harper & Row, 1976

"The spotlight will shift to the governance of institutional investors, with a focus on how institutions should best fulfill their conflicting duties to maximize returns while acting as responsible owners".

John Wilcox, Directors & Boards Magazine, 4th Quarter 2006, p. 93

...money managed collectively for the benefit of others must be managed for the beneficiaries' exclusive interest in a transparent system with checks and balances to prevent misuse of fund assets and abuse of the inordinate economic and political power that accompanies control of such large pools of wealth.

member pension funds that make up the Council of Institutional Investors have over $3 trillion in aggregated assets.[5] Even within this smaller subset of institutional investors one finds incredible differences in form and structure yet the people in charge of the funds face common and complicated demands on their multiple positions as corporate officer, union chief, or government official.

It is clear that given the variety of institutional investors and the legal regimes that created them there can be no one universal solution to the issues besetting fund governance. Any set of best practices must be flexible and adaptable to the unique circumstances of each fund. Nevertheless, the general intent of the following principles can and ought to be adopted by all fund trustees interested in securing better governance of institutional investors and protection of the fund assets they control.

It is incumbent upon all members of the institutional investor community to join together to develop tools and principles to protect and preserve the fundamental fiduciary principle: money managed collectively for the benefit of others must be managed for the beneficiaries' exclusive interest in a transparent system with checks and balances to prevent misuse of fund assets and abuse of the inordinate economic and political power that accompanies control of such large pools of wealth.

Over a decade ago experienced professionals from public and private investment funds[6] together with former officials, academics, and other interested parties came together at Stanford Law School to share their mutual knowledge and experience regarding the role of large institutional investment funds in the nation's economy. The participants recognized the value in forming an ongoing forum where they could continue to discuss the unique legal, regulatory, and market challenges institutional investors encounter as they attempt to fulfill their fiduciary duties to their beneficiaries. The original organizers agreed to establish the Stanford Institutional Investors' Forum ("the Forum") as a member supported association which meets approximately twice a year at Stanford Law School. [7]

Through our work in the Forum and our individual professional experience Committee members have developed substantial insight in the governance of institutional investment funds. We have witnessed in our own careers the many challenges facing those charged with a fiduciary duty to invest and protect fund assets for their beneficiaries.

Interested Forum members organized the Committee to develop a set of fund governance best practice principles. The Committee members were motivated by recent instances that have highlighted the shortcomings of existing governance practices. The losses associated with these situations raise concern about fiduciary protection on the one hand and the potential for burdensome regulation on the other. In addition, poor fund governance practices could weaken institutional investors' legitimate demands that public corporations adhere to a high standard of corporate governance.

Committee members understand that there are many different kinds of institutional investors and therefore, several varied forms of fund governance structure, e.g., elected or appointed boards, single

5 Davis, Stephen et al., "The New Capitalists", Harvard Business School Press, 2006, p. 80.

6 Including Barclays Global Investors, the California Public Employees' Retirement System, Franklin Templeton Investments, the California Teachers' Retirement System, Intel, et al.

7 The Forum generally meets once in the Spring and once in the Winter. Most meetings occur at the Stanford Law School with occasional meetings scheduled in New York or Washington, D.C.

trustees, corporate officers, etc. However, members generally believe that certain fundamental standards exist or ought to exist in managing and administering such large concentrations of wealth. Committee members recognize that these fundamental standards generally have not been well articulated in the past. The Committee developed the following fund governance principles to promote these fundamental standards and to assist those parties dedicated to fulfilling their fiduciary obligations and protecting their beneficiaries' assets.

We acknowledge that no rigid set of rules can govern effectively all the different varieties of institutional investors. Yet we believe that these collective pools of wealth, created for their beneficiaries' welfare, can and do have commonalities.

We have focused on five key categories that together in our view form the fabric of best governance practices. These categories cover: 1) the fundamental need for transparency regarding a fund's principle rules and governance; 2) a fund's leadership through its governing body and executive staff; 3) the identification of key trustee attributes and core competencies; 4) a fund's approach to addressing conflicts of interest and related disclosure issues; and 5) the delegation of duties and allocation of responsibilities among relevant fund parties.

We encourage peer institutional investors, advisors, managers, portfolio companies and all other financial market entities to consider adoption of these principles and other ethically sound business practices and policies that focus on long-term sustainability and real value creation. With faith in the desire of every fiduciary to care properly for the trust placed in him or her, we propose the following fund governance best practice principles.

Peter Clapman, Chairman

"Practice what you preach. Funds cannot credibly demand governance standards of corporations that they will not meet themselves."

STEPHEN DAVIS
Stephen Davis, Jon Lukomnik, and David Pitt-Watson, "The New Capitalists", Harvard Business School Press 2006, p. 220.

Fund Governance Best Practice Principles

A. Transparency of a Fund's Rules and Governance Structure

SUMMARY:

» *A fund should **clearly define** and make publicly available its **governance rules.***

Principles:

1. The rules and principles controlling a fund's governance and management of actual and potential conflicts of interest should be gathered in one location that is clearly accessible to all persons involved in the governance process, as well as to members of the public. These rules and principles should include all relevant statutes, regulations, policies, statements, charters, or other documents that relate to the governance process. If there are material judicial rulings relevant to the process, it is advisable that they be included as well. The materials should be updated periodically to reflect new legislative, regulatory, policy, or litigation developments.
2. These documents will ideally be posted on the fund's website or at a location that is readily accessible to fund beneficiaries and to all relevant parties with an interest in the fund's governance structure.
3. In addition to public posting, a fund might consider requiring an annual affirmation from all members of its governing body that they are familiar with the relevant principles and that they are either in full compliance or that they have disclosed to the appropriate authority any situation that raises a potential issue regarding compliance.

Commentary:

By gathering the documents related to a fund's governance in a single source, the organization can make clear to its governing body, its employees, and its beneficiaries, the standards that govern its conduct. The opportunity for misunderstanding within the organization, and between the organization and the public, should then be reduced. A clear articulation of relevant governance standards also allows the fund to compare its standards with peer organizations so as to determine whether there are opportunities to improve its governance practices. Governance principles falling within this fundamental principle of transparency should include principles governing selection, retention, and exercise of voting and other powers with respect to the fund's assets.

B. A Fund's Leadership: the Governing Body and Executive Staff

SUMMARY:

- *A fund should* ***identify and disclose its leadership structure*** *and all persons in positions of senior responsibility.*
- *A governing body should* ***consist of appropriately qualified, experienced individuals*** *dedicated to fulfilling their fiduciary duties to fund beneficiaries.*
- *A governing body should* ***promote polices that strengthen fiduciary principles in the selection and monitoring of trustees*** *and that enable trustees to fulfill their fiduciary responsibilities. Where trustees are elected to a board to represent a class of fund beneficiaries, the elected trustee should take reasonable steps to acquire the skills to serve appropriately as a fiduciary.*
- *A fund should* ***establish clear lines of authority*** *between its governing body and its staff that reflect a commitment to representing beneficiary interests. Delegations of authority from a governing body to its staff should be clearly defined and regularly reviewed.*
- *A governing body should have* ***authority to select or dismiss key staff*** *and independent advisors and counsel. Trustees should establish and maintain regular processes by which staff performance is measured. The standards governing staff evaluation should be clearly communicated to the staff.*

Principles:

1. A fund should disclose its leadership structure and identify all persons in positions of senior responsibility. The fund should also clearly articulate the responsibilities held by each member of its leadership group and each person in a position of senior responsibility. The fund should make clear how the institution is governed, describe the structures responsible for developing and implementing fund policies, including those governing the scope of trustee duties, the investment management process, and the selection and monitoring of executive personnel.
2. A governing body should consist of appropriately qualified, experienced individuals dedicated to fulfilling their fiduciary duties to fund beneficiaries. Viewed as a group, the board should be composed of individuals with a portfolio of skills that allows it to make responsible, informed investment and legal decisions, and to discharge its fiduciary obligations to fund beneficiaries. The presence of *ex officio* members on a board does not diminish the obligation that the board, as a whole, has to have the skill and experience necessary for it to perform its obligations.[8] Where trustees are elected to a board to represent a class of fund beneficiaries, the elected trustee should take reasonable steps to acquire the skills to serve appropriately as a fiduciary. Ideally, each trustee will have significant, relevant experience or expertise that can contribute to

8 The committee recognizes that in many instances, trustees will serve *ex officio* and may not have qualifications that are otherwise expected of a fund fiduciary. In such instances, the *ex officio* trustee should recognize that his or her fiduciary duties to the fund beneficiaries are preeminent when deciding on fund issues. Additionally, *ex officio* trustees should seek to develop the skills and training outlined in these principles. If an *ex officio* trustee relies on another individual to represent the *ex officio* trustee or provide counsel, then it is a best practice that the representative possess the appropriate skill and training required of a fiduciary as outlined in these principles.

Principles: (continued)

the responsible resolution of the complicated decisions likely to affect fund assets, beneficiary benefits, and related matters.[9] The trustees should be individuals dedicated to fulfilling a fiduciary duty to fund beneficiaries and should have qualifications and experience consistent with standards for service as a fiduciary. At a minimum, the relevant fiduciary standard should include: undivided loyalty to the fund beneficiaries; the exercise of care, skill, prudence, and diligence appropriate to the prevailing circumstances; diversification of investments; the duty to act in accordance with plan documents governing fund performance; the duty to avoid unreasonable favoritism toward one beneficiary group over another; the duty to limit fund expenses to amounts that are reasonable and appropriate; the delegation of duties, when appropriate, to prudently select, instruct, and monitor agents; and the duty to refrain from prohibited or conflicted actions.

3. Trustee selection should be made in a manner that provides effective accountability to fund beneficiaries. If a state constitution, statute or local ordinance prescribes trustee membership selection in a manner that could be inconsistent with the appropriate exercise of fiduciary responsibility on behalf of fund beneficiaries, then the trustees should seek legislative amendments as necessary to provide an appropriate governance and fiduciary structure. Trustees should reject pressure to make a decision or to act in a manner that conflicts with their fiduciary duties. After a determination through due process as established by the fund, trustees who act contrary to the beneficiaries' exclusive interest should face sanction or removal.
4. A fund should establish clear lines of authority between a governing body and its staff that reflect a commitment to representing the beneficiaries' interests. Delegations of authority from the board to the staff should be clearly defined and regularly reviewed.
5. Trustees should have authority to select and dismiss key executive staff. However, executive staff must be qualified and able to fully discharge their duties. Trustees must therefore not allow undue influence to be exerted on staff, usurp the function of staff, nor allow staff to usurp the function of trustees. To preserve the delicate balance of authority and responsibility between the board and staff, the fund should develop and publicly disclose a charter that articulates the role and responsibility of trustees and staff. The charter should also describe the process that determines the hiring and dismissal of key staff and provide for a regular scheme to assess staff performance. Public fund boards should ensure that the charter process conforms to state personnel rules and regulations. Where necessary to ensure that trustees act in the beneficiaries' fiduciary interest, trustees should have direct access to unconflicted, appropriately qualified external counsel and consultants.

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9 Where a fund uses the rare form of a sole trustee for its governing body, it should also establish an advisory committee consisting of experienced individuals with a balance of appropriate skills necessary to render informed counsel on fund investment and legal matters, as well as on other matters of fiduciary judgment that might arise.

Commentary:

By identifying the individuals who constitute the leadership structure and articulating their roles and authority, the fund will make itself more accountable to its beneficiaries who can in turn more effectively monitor and evaluate trustees and senior management. Transparent allocations of authority will minimize misunderstandings among board and staff and give rise to efficient decision-making processes.

Requiring that trustees possess or obtain appropriate experience and qualifications helps assure that the board as a whole has the skills and knowledge necessary to make a meaningful evaluation of the relevant investment, legal, and administrative issues. A member of a governing body has appropriate experience and qualifications if she or he has the experience and qualifications that a similarly situated reasonably prudent investor would expect from a fiduciary. In assessing whether a specific individual satisfies the criteria for experience and qualifications, the organization should focus on ensuring that the board as a whole has the portfolio of skills necessary to fulfill its fiduciary function.Trustees exceed their authority in exercising hiring or dismissal authority over executive staff if their decisions conflict with fiduciary principles.

C. Trustee Attributes and Core Competencies

SUMMARY:

- *Each trustee should* ***have a thorough understanding of the fund's obligations*** *to its beneficiaries, the fund's economic position and strategy, and its relevant governing principles. Each trustee must be able to make decisions based solely on the objective requirements of the trustees' fiduciary duties to fund beneficiaries. Each trustee should be inquisitive and should appropriately question staff, advisors, and fellow trustees as circumstances require. Each trustee should also contribute to a balanced set of skills that enables the board, acting as a collective body, to execute successfully its obligations.*
- *The board should at all times* ***include individuals with investment and financial market expertise and experience*** *relevant to the fund's ability to exercise its fiduciary obligations to its beneficiaries.*
- *Trustees, on a regular basis, should* ***obtain education that provides and improves core competencies,*** *and that assists them in remaining current with regard to their evolving obligations as fiduciaries.*
- *Trustees should be able to* ***obtain intelligible explanations*** *of recommended actions from staff, advisors, or colleagues.*
- *The fund should* ***engage in an annual evaluation of trustee skills*** *and, where appropriate, should develop a plan for improving and expanding the board's competencies.*

Principles:

1. While recognizing the diversity of experience, knowledge, and training that fund trustees should possess, there are certain attributes and core competencies that each individual trustee should possess or acquire so that a governing body is able to perform its essential obligation. These attributes and core competencies include:
    a. an abiding loyalty to the best interests of the fund's beneficiaries;
    b. the capacity to dissociate one's personal viewpoints from the objective requirements of the trustee's fiduciary obligations to fund beneficiaries;
    c. the willingness and ability to dedicate the time and attention required to satisfy the duties of serving as a fiduciary;
    d. a competent understanding of the environment in which the fund operates, as well as of the economic and structural relationships among beneficiaries, trustees, staff, consultants, agents, and investment managers;
    e. a competent understanding of the obligations and responsibilities inherent in a fiduciary relationship;
    f. an inquisitive nature that promotes the careful consideration of recommendations regarding fund opportunities and administration;
    g. an ability to consider and debate issues in a civil and constructive, yet thorough manner;

Principles: (continued)

h. effective communication skills that enable the trustee to provide and receive information with clarity and understanding;

i. interpersonal skills that allow the trustee to engage in appropriate exchanges with fellow trustees and staff, and that recognize the value of negotiation, compromise, cordial relationships, and professional dealings based on respect and fairness; and

j. a substantive base of knowledge that contributes to the board's balance of investment, fiscal, legal, policy and accounting expertise, so that, as a whole, the board can properly analyze and understand staff and consultant recommendations and fulfill its fiduciary obligations.

2. While a trustee is still acquiring a core competency, the trustee should be sufficiently confident to insist that staff or fellow trustees provide substantive explanations presented in a manner that permits the trustee to understand the potential consequences of his or her decision in approving or denying a recommended course of action.[10]

3. Every governing body should have a sufficient number of members skilled in the disciplines necessary for effective fund management so that the governing body, acting as a collective entity, possesses a portfolio of skills and abilities that allow it to effectively discharge its fiduciary obligations. A governing body should, in particular, consist of a sufficient number of trustees competent in financial and accounting matters so that the body is capable of understanding modern portfolio theory, diversification principles, basic financial analysis, and fundamental accounting principles.[11]

4. Trustees should engage in an annual evaluation of the portfolio of skills and interests represented on the governing body to determine whether the governing body has a composition consistent with the responsible execution of its fiduciary obligations. Incorporating the results of the evaluation, the trustees should adopt an annual process for identifying any shortcomings attributable either to the body's current or anticipated composition, or to changes in fund management requirements or responsibilities, as well as a process for addressing any identified deficiencies or opportunities for acquiring any skills or expertise determined to be lacking.

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10 With this principle, the Committee aims to address its concern arising from the Enron bankruptcy where subsequent narratives revealed a repeated and apparent purposeful tactic on the part of Enron staff to intimidate any person who attempted to question Enron's complex financial arrangements by aggressively belittling and demeaning the questioner. This principle holds that a trustee's fiduciary duty includes a requirement that each trustee should challenge staff, advisors, or even fellow trustee to provide explanations intelligible to the trustee when seeking the trustee's vote for a proposed course of action. If a trustee believes that staff, advisors, or fellow trustees are employing intimidation tactics, the trustee should at a minimum abstain from voting on the proposed course of action.

11 This requirement is the investment fiduciary analogue of the requirement imposed by the Sarbanes-Oxley Act of 2002 that the boards of publicly traded corporations contain audit committees composed of independent directors and have at least one "audit financial expert" on the audit committee or explain why it does not . (See, 15 USCA § 7265 and also 17 CFR 229.401(h)(1)(i)). Under the rules adopted by the SEC, an audit committee financial expert has all of the following attributes:

- an understanding of generally accepted accounting principles and financial statements;
- the ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves;
- experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to breadth and complexity of issues that can reasonably be expected to be raised by the registrant's financial statements, or experience actively supervising one or more persons engaged in such activities;
- an understanding of internal controls over financial reporting; and
- an understanding of audit committee functions.

(See 17 CFR 229.401(2)). The same considerations that led Congress to the conclusion that the presence of such expertise at the board level, not merely the staff level, would be beneficial for shareholders and society also supports the conclusion that the presence of analogous financial and investment expertise at the governing body level, and not only at the staff level, would be beneficial for funds, their beneficiaries, and society.

Commentary:

Modern fund trustees must have appropriate experience and knowledge to ensure they can substantially and materially evaluate the issues presented to them. Beneficiaries expect more from today's trustees than in the past because institutional investors are more complex and face markets that are more complicated, in certain aspects less regulated, and increasingly more global than in prior times. Also, demographic realities mean that public pension funds in particular may have less time to recover from market downturns, or from poor investment decisions than in the past because aging beneficiaries will soon begin drawing on fund assets.

While these principles acknowledge flexibility to accommodate individuals who may lack specific legal or investment management experience or knowledge, but who offer unique contributions to the board's portfolio of skills, such flexibility should be narrowly construed and should be exercised in a manner consistent with fiduciary principles.

The board should make public the annual evaluation of individual and collective trustee skills and experience.[12] Public disclosure will provide an additional bulwark against inappropriate appointments to a governing body. If necessary to ensure full participation in the evaluation process, results may be listed such that individual trustees are not specifically identified by name.

12 "Annual evaluation of individual and collective trustee skills and experience" does not refer to the traditional board performance self-evaluation. The Committee is not suggesting that the latter be publicly disclosed.

D. Approach to Addressing Conflicts of Interest and Related Disclosure Policy

SUMMARY:

- *A fund should* ***establish and publicly disclose its policy for dealing effectively and openly with situations that raise either an actual conflict of interest or the potential for the appearance of a conflict of interest.*** *A fund should clearly identify the persons subject to its conflict policy ("covered persons") and should provide appropriate training to those covered persons.*
- *In order for a conflict of interest policy to be effective, appropriate authorities with the ability to act independently of any potential conflict must have access to information that adequately describes trustee and staff interests and relationships that could, at a minimum, give rise to an appearance of impropriety. A fund should therefore* ***establish a regular, automatic, process that requires all covered persons to report and disclose actual or potential conflicts of interest.***
- *Trustees and staff should periodically affirm and* **verify compliance** *with conflict rules, regulatory reporting requirements, and other policies intended to protect the fund against the actuality or appearance of interested transactions and conflicts.*
- *Trustees and staff should* ***under no circumstances pressure anyone, whether or not a covered person, to engage in a transaction that creates an actual conflict or an appearance of impropriety.*** *Trustees and staff should be required to disclose any such attempts to a proper compliance authority as determined by the board.*
- *A fund should* ***publicly disclose necessary information*** *as specified below to ensure that trustees and staff are fulfilling their fiduciary duties to beneficiaries.*

Principles:

1. The fund should establish and publicly disclose its policy for dealing effectively and openly with situations that raise either an actual conflict of interest or the potential for the appearance of a conflict of interest. A "conflict of interest" should be defined as encompassing any situation in which a covered person has, or could reasonably be perceived to have, an incentive to decide a matter or provide a recommendation for any reason that would be inconsistent with the fund beneficiaries' best interest, or that would provide a private benefit to the covered person. Trustees have a fiduciary responsibility to protect the investment fund from actual and potential conflicts of interest and to ensure that decisions with respect to selection, retention, and exercise of voting and other powers with respect to the fund's assets will be made on an informed basis and solely in the interests of the fund's beneficiaries.[13] Also, it is generally in the fund's best interest to adopt policies that prevent even the appearance of a conflict of interest. The fund's policies should, at a minimum, require recusal of all trustees and staff (or the relevant "covered persons") from matters in which they have an actual conflict of interest. In situations where there is an appearance

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13 Beneficiary trustees are held to a higher standard of fiduciary duty and loyalty than that for corporate board directors. *Meinhard v. Salmon*, 249 N.Y. 458, 464 (1928); *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 110 (1989); *NLRB v. Amax Coal Co.*, 453 U.S. 322, 334 (1981); *Leigh v. Engle*, 727 F,2d 113, 124 (7th Cir. 1984); *Donovan v. Bierwirth*, 680 F.2d 263 (2nd Cir.), cert, denied, 459 U.S. 1069 (1982).

Principles: (continued)

of impropriety, the fund's policies should, at a minimum, establish procedures to be followed in order to determine that the appearance does not, in fact, give rise to an actual conflict. The fund may also responsibly decide to require recusal of "covered persons" in situations where an appearance of impropriety is present, even though there is no actual conflict. The fund should clearly identify the persons subject to its conflict policy and should provide appropriate training to those covered persons.

2. In order for a conflict of interest policy to be effective, appropriate authorities within the fund must have access to information that adequately describes covered persons' interests and relationships that could, at a minimum, give rise to an appearance of impropriety. The fund should therefore establish a regular and automatic process that causes covered persons to have the obligation to self-identify potential and actual conflicts of interest, as well as situations that could give rise to an appearance of impropriety. The process should include methods for individual trustees or staff to bring a conflict to the attention of the trustees and a process for the trustees to analyze and resolve the conflict. The process should include a procedure to record conflicts within a governing body's minutes and provide appropriate disclosure of those conflicts. The fund should identify all persons who are covered under the conflicts policy and provide covered individuals appropriate training as to the identification and reporting of actual, potential, or apparent conflicts. The policy should also identify the reporting and enforcement authority and set forth potential disciplinary actions that can result from violations of the fund's conflicts policy. Covered persons should provide a statement of personal holdings and should submit periodic descriptions of all financial transactions or other relationships that are related to the fund's investment or other activities. The fund should establish and maintain procedures designed to assure the confidentiality of such information, unless there is a legal obligation to provide public disclosure.
3. Trustees and executive staff should at least annually verify and publicly report on the following as relevant:
    a. Compliance with regulatory requirements (SEC, CFTC, state agencies, etc.);
    b. Compliance with the fund's own governance standards, policies and procedures;
    c. Compliance with the fund's Code of Ethics;
    d. Compliance with standards governing the reporting of performance and, where applicable, funded status of defined benefit plans;
    e. Compliance with rules governing gathering and retaining appropriate records and documents;
    f. Compliance with rules governing personal investment transactions;
    g. The suitability of all investments made by the fund in the current or previous year given the fund's fiduciary standard, investment objectives, and investment policies.
4. Trustees and staff should under no circumstances pressure anyone to engage in a transaction that creates an actual conflict or an appearance of impropriety. Trustees and staff should be required to disclose any such attempts to a proper compliance authority as determined by the board.
5. The fund should publicly disclose:
    a. The fund's trading policies and procedures including commissions paid;
    b. Any referral fees paid by the fund;
    c. The role of any external entities in setting policy and strategy for the fund or for any external investment manager used by the fund;
    d. An annual summary of actual or potential conflicts of interest that were identified and how they were managed or controlled (e.g., situations involving recusals);

Principles: (continued)

e. A detailed annual statement of risks to the fund in the nature of a risk factors disclosure that might be contained in a registration statement filed with the United States Securities and Exchange Commission;

f. A statement and quantification, based on realistic economic and financial assumptions, of the fund's liabilities and description of how investment practices are structured to satisfy those obligations over the long-term.

g. The fund's policy on personal investment transactions as well as a statement that all covered persons have complied with rules governing personal investment transactions, together with a description of any exceptions from compliance;

h. The fund's policy on receipt of gifts and entertainment for covered persons as well as an annual statement that the gifts and entertainment policy has been complied with together with a description of any exceptions from compliance;

i. An annual statement of the fund's holdings and performance;

j. An annual statement describing whether and how the fund and its trustees have fulfilled the best practices as set forth herein;

k. An annual report of the fund's contracting process and of material contracts let;

l. A description of proxy voting policies and proxy votes cast, including those by external managers with respect to fund investments, to the extent not otherwise disclosed by the fund.

Commentary:

Addressing conflicts of interest and ensuring that fund decisions are not inconsistent with the beneficiaries' interests is a fundamental duty of a reasonably prudent fund fiduciary. Failing to implement appropriate protections against conflicted decisions may be considered negligent conduct. Trustees must at a minimum take appropriate steps to implement effective conflicts policies to address and disclose conflicts, both those that challenge a governing body and those that face fund staff and consultants. A fund's conflicts policy and its definition of actual and apparent conflicts of interest, as well as its disclosure of covered persons, are a fundamental bulwark in protecting the fund from misuse.

In adopting a conflicts policy, a governing body should include an explanation of how it defines a conflict of interest. If the definition used by a governing body is substantially different than the definition outlined in these principles, the policy should include a statement explaining how and why the policy departs from the definition provided in these principles. The definition should provide specific examples of actions that would be an actual conflict or that would raise the appearance of a conflict.

Because a clear and robust conflicts policy is a fundamental defense against the misuse of fund assets, trustees in particular should have a complete understanding of the fund's conflicts policy. The fund should provide comprehensive training specifically for trustees in addition to any training provided for all covered persons. The training should emphasize issues focused on the trustees' particular responsibility for defending the fund and for ensuring the conflicts policy is implemented and maintained appropriately. The training should include clear examples of both actual conflicts and actions that raise the appearance of a conflict of interest. Examples should include degrees of varying seriousness with recommendations for appropriate action ranging from recusal or abstention to disclosure. Trustees should affirm at least annually that

they have completed the fund's conflicts training program, that they understand the fund's conflicts policy, and that they agree to comply with it.

In defining "covered persons" for purposes of the fund's conflicts policy, a governing body should include its own members, the fund's executive and investment staff, legal counsel, and any other individual or corporate person who has the ability to make material decisions as to the use and disposition of fund assets, including decisions as to the careers of fund personnel. If any person whom a reasonably prudent, similarly situated governing body would include in a conflicts policy is not included as a covered person in the fund's conflicts policy, the fund should identify that person and explain why the person is not included as a covered person.

Trustees should take particular care not to rely exclusively on any one source of information for investment, legal or administrative counsel when dealing with material issues but should instead weigh advice from independent, non-conflicted professionals. In short, trustees should put in place some mechanism to protect the fund from improper business relationships.

A conflicts policy must include a well developed disclosure and reporting process to be effective. A governing body must take steps to ensure that the disclosure and reporting process is transparent and protected from co-option by conflicted parties. This may require redundant procedures and reporting responsibilities so that no one individual controls the process. At a minimum, a governing body should identify a reporting and enforcement authority. However, dividing the reporting and the enforcement functions may serve to strengthen the conflicts policy by ensuring that at least two separate authorities are aware of any reportable conflicts, real or potential.

The process should be regular and automatic by which the Committee means that covered persons should be required to disclose the requested information in a standardized format at standard intervals but at least annually. To clarify, the fund should not rely on covered persons to determine when and what to report but should establish a routine reporting process with established reporting deadlines.

The Committee recognizes that the disclosure of covered persons' personal relationships and private financial interests are controversial to those who must adhere to the disclosure policy. While a governing body should strive to find the right balance between obtaining necessary information to ensure compliance with the fund's conflicts policy and respecting the privacy expectations of covered persons, covered persons should acknowledge that their position in such sensitive roles requires a greater sacrifice of personal privacy than the average professional.

In addition to disclosure policies related to address potential or actual conflicts of interest, governing bodies should consider the numerous other disclosure requirements mentioned in these principles. Disclosure of and verification of compliance with these other requirements is no doubt burdensome. However, the Committee believes that they contribute significantly to the fund's protection. By allowing interested parties access to key information, a governing body increases the number of sentries at the fund's vault.

E. Delegation of Duties and Allocation of Responsibilities Among Relevant Authorities

SUMMARY:

- *A governing body should be* ***permitted to rely on the expertise and advice of appropriately selected and unconflicted consultants and staff.*** *Trustees should also be permitted to delegate responsibilities, subject to appropriate oversight, to unconflicted consultants and staff.*
- *A fund should* ***require that any consultants or staff*** *from whom material advice is requested or received, or to whom material responsibility is delegated,* ***comply with the fund's conflict of interest and ethics policies***
- *A fund should* ***institute an evaluation process that assesses proposed fund expenditures*** *and weighs the benefits to fund beneficiaries generated by those expenditures against the cost and quality of the service for which funds are expended.*
- *A fund should* ***establish an effective and objective monitoring policy for all service contracts*** *including those for asset managers and investment consultants.*

Principles:

1. A governing body should be permitted to reasonably rely on the expertise and advice of appropriately selected and unconflicted consultants and staff. Trustees should also be permitted to delegate responsibilities, subject to appropriate instruction and oversight, to unconflicted consultants and staff. Trustees should also understand that delegating authority does not relieve them of their own fiduciary responsibilities, particularly to select and monitor staff and consultants in a manner consistent with the trustees' fiduciary obligations. Governing body members should therefore adopt and implement procedures designed to assure that consultants and staff are aware of the trustees' fiduciary obligations, as well as of all relevant policies and procedures governing consultant and staff conduct.
2. A fund should require that any consultants or staff from whom material advice is requested or received, or to whom material responsibility is delegated, comply with the fund's conflict of interest and ethics policies. In particular, consultants should be required to disclose all relationships with providers or suppliers that they recommend to the fund so that the fund's trustees and staff can determine whether these relationships give rise to an appearance of impropriety or to an actual or potential conflict of interest. Failure to disclose a relationship in accordance with fund policy should be considered a *prima facie* basis for termination of a consulting relationship.
3. Trustees should develop a plan that defines the appropriate delegation of decision making authority for ordinary as well as critical tasks, including contracting procedures and the performance of internal audits. The plan should identify decisions by category such as investment management, auditing, asset allocation, personnel, internal controls, and contracting. It should also assess the complexity of the task; the requisite skill and resources required to accomplish the task; the task's level of importance to the fund as measured in relation to the beneficiaries' fiduciary interest; and how and to whom to appropriately delegate decisions regarding the task. The plan should allocate authority in inverse proportion to the importance of the task to the fund. Thus, minor tasks may be completely delegated to staff but extremely important tasks may be restricted to decisions by trustees or require trustee participation. Delegates should be properly instructed as to their duties, ethical obligations, and performance expectations.

Principles: (continued)

4. The fund should evaluate proposed fund expenditures and weigh costs of proposed services against the expected benefits to be generated to fund beneficiaries. Long-term risks, returns, and intangible factors may be part of this analysis. The trustees should approve services only where the evaluation indicates that the costs are reasonable and a benefit to the fund or its beneficiaries is reasonably anticipated.
5. The trustees should establish an effective, objective monitoring policy for all service contracts, including those for asset managers and investment consultants. The monitoring policy should establish appropriate benchmarks for contractors as well as reasonable monitoring periods over which the contractors' performance and effectiveness should be measured. The policy should also set forth a process for evaluating contractors' performance and continued competitiveness, as well as the termination of contractors that do not meet the fund's requirements. The trustees should review and update the monitoring policy as needed.

Commentary:

Effective fund administration is highly dependent upon the quality of the relationship between trustees and staff. Therefore, a governing body must exercise an appropriate balance between its own leadership role and the independence of staff in effectively executing board policies. A governing body should essentially set strategic policy and provide goals and objectives to guide staff. The board should also have pre-established performance criteria for the executive staff and should have a process to regularly communicate its assessment of the executive staff's performance. Executive staff should have the freedom to achieve the benchmarks set out by the board without undue influence from trustees.

Ideally, the board should consist of appropriately qualified individuals who are held accountable by the fund's beneficiaries. Where that is the case, the board may have more freedom to direct and control staff. However, where other factors dictate the composition of the board, such as requirements for *ex officio* membership, the balance should tip more to professional expert staff who are committed to administering the fund for the long-term objectives of providing for the fund's beneficiaries. The key factor in deciding whether trustee or staff should address a particular issue consists of analyzing who can best ensure that the fund's beneficiaries' interest will be fulfilled. Boards and staff should recognize the distinctively separate policymaking and implementation roles that each plays in fund governance. Usurpation by boards of duties reserved to staff, and vice versa, can undermine the ability of each to effectively perform its own functions in an unbiased manner.

Conclusion

The Committee members believe that institutional investors serve an important purpose in the nation's economy. The significant pools of wealth controlled by institutional investors provide for an effective means of financing retirement, education, charities, and other important economic objectives. They do so while providing investment capital to fuel our marketplace and create the innovation and technology that produce jobs now and for the future. In their best form, institutional investors can contribute to a dynamic cycle of beneficial economic activity that enriches both the national and global economies.

The Committee recognizes that the vast majority of fund professionals and trustees are intelligent, dedicated, hardworking, honest individuals who strive to fulfill their fiduciary obligations to fund beneficiaries. The Committee also recognizes that it is impossible to describe a universally effective governance process, and that no governance process can provide for an absolute defense against the misuse of fund assets by unscrupulous trustees, investment managers or advisors.

Years ago, few observers anticipated the immense influence that institutional investors would come to assert on the corporate and political spheres. With this influence comes increased responsibility, and the governing bodies of these institutional investors must evolve the skill mix necessary firmly to protect funds against the disquieting prospects of influence peddling, fraudulent investment reporting, corruption, unaccountability, and potentially massive transfers of wealth from the beneficiary owners to favored service providers, money managers, and consultants.

Nor can we forget that in the last few years every kind of institution in American society, from government, to industry, to the church, has experienced unexpected scandals. The lesson in each instance is that every institution is vulnerable to unethical conduct. The best defense against those who would misuse the trust of others is to ensure the institution has transparent governance, where the individuals in charge are accountable to the beneficial owners through established procedures that strengthen the fiduciary relationship between trustee and beneficiary.
We have set forth above our attempt at defining a minimum set of best practice principles and standards to help funds ensure that their trustees have the skills and oversight mechanisms necessary to protect their funds and to manage fund assets appropriately in the best interests of fund beneficiaries. We look forward to the comments and contributions of our colleagues who we hope will join us in our endeavor.

Appendices

Appendix A

About the Stanford Institutional Investors' Forum

Forum membership is by invitation only[14] and is closed to the media to allow Forum participants and guests to engage in frank discussion aimed at identifying industry concerns and improving industry practices.[15]

Members of the Forum, including Faculty Advisors[16] from the Law School, work closely with the Rock Center for Corporate Governance[17] at Stanford University in analyzing matters affecting institutional investors, developing executive and fiduciary education programs, presenting seminars and conferences, and in supporting academic research for improved corporate governance.

The positions taken by the Forum are those exclusively of the Forum members. They are not endorsed by nor do they represent the views of The Rock Center, Stanford University, nor the Stanford Law School.

14 Membership information can be obtained from the Program in Law, Economics and Business at Stanford Law School. Forum funding is provided through annual membership fees set at four levels: Forum Partners at $25,000; Forum Associates at $15,000; Forum Sponsors at $10,000; and Forum Members at $7,500 per annum respectively.

15 Forum meetings are designed to be informal and allow for maximum dialogue among Forum members in a "round-table" format. Occasionally, the Forum invites subject matter experts to conduct presentations on specific topics of interest to Forum members.

16 Joe Grundfest and Richard Koppes.

17 The Rock Center for Corporate Governance was established in 2006 by a generous gift from Arthur T. Rock and Toni Rembe to promote the study of corporate governance. Information about the Rock Center and its many activities including its SEC seminars can be found at the Stanford Law School website www.law.stanford.edu/program/centers/rcfcg.

SIIF Committee on Fund Governance

The members of the SIIF Committee on Fund Governance ("the Committee") are current and former representatives of some of the nation's largest and most influential institutional investors and academic and corporate governance practitioners.

Peter Clapman, Chairman

Retired Senior Vice President and Chief Counsel for TIAA-CREF; Partner, Governance for Owners; CEO Governance for Owners US corporate governance operations; Senior Advisor to Galileo Global Advisors; board member of the National Association of Corporate Directors (NACD) and faculty member, NACD's Corporate Directors Institute; Independent Chairman and Corporate Governance Committee Chair, AARP Mutual Funds Board of Trustees; NASDAQ Listing Council member; NYSE Working Group on Proxy Voting member; board member, Ipass, a Nasdaq Listed Company; Member, Stanford Institutional Investors' Forum and faculty member, Fiduciary College and Directors College at Stanford Law School; board member, corporate governance advisory committee of the University of Delaware Business School and the Yale Milstein Center for Corporate Governance; Chairman, IRRC Institute; former Chairman of the International Corporate Governance Network (ICGN); former member of the London Stock Exchange Primary Markets Group and the New York Stock Exchange Legal Advisory Committee.

Mr. Clapman is a graduate of Princeton University, and earned the J.D. degree from Harvard Law School. He was elected a member of the American Law Institute (ALI) in 1993.

Mark Battey

Managing Director, Miramar Capital LLC; Former Trustee, the California State Teachers' Retirement System (CalSTRS); Former Chief Deputy Controller, State of California; Chair, Mid-Peninsula Housing; Chair, Coastside Adult Community Center Capital Committee; Board member, New California Network; Co-Founder and former CFO, Essex Environmental, Inc.

Mr. Battey earned an MBA from Stanford University, an MSC in International Relations from the London School of Economics, and a BA from Harvard University.

Margaret M. Foran

Ms. Foran is Senior Vice President-Corporate Governance, Associate General Counsel and Corporate Secretary of Pfizer Inc. Prior to joining Pfizer in July 1997, she was an Associate General Counsel and Assistant Secretary of ITT Corporation from July 1996 until July 1997 and a Vice President, Assistant General Counsel and Assistant Secretary for J. P. Morgan & Co., Inc., as well as Secretary of Morgan Guaranty Trust Company of New York, where she was employed for approximately 12 years. Previously, she was an associate with Reid & Priest.

Ms. Foran received B.A. (Magna Cum Laude) and J.D. degrees from the University of Notre Dame. She is admitted to the New York and Pennsylvania Bars. Ms. Foran is a former Director of The MONY Group Inc and MONY Life Insurance Company. She is a Board Member of Legal Momentum. She is a member of the Board of Trustees of the Securities and Exchange Commission Historical Society. She is a member of the Board of the International Corporate Governance Network Board of Governors (ICGN). She serves as Co-Chair of the Council of Institutional Investors (CII). She is a member of The Economic Club of New York. She serves on the Corporate Directors Institute's Independent Advisory Board of the National Association of Corporate Directors (NACD). She is a member of the Disclosure Task Force and Co-Chair of the Director Voting Task Force of the American Bar Association's Committee on Corporate Laws and Chair of the ABA Committee on Corporate Governance. Ms. Foran is a Director of the Association of Corporate Counsel (ACC), a member of the Executive Committee and the Finance and Audit Committee, the past Chair of the ACC's Corporate and Securities Law Committee, a member of its New York Chapter and a recipient of ACC's 1998 "National Committee Member of the Year." Ms. Foran is a former Chairman, a former director (1996-1999), the former Chair of the Securities Law Committee, and the former

Treasurer of the American Society of Corporate Secretaries (ASCS). She is the former Chair of both the Coordinating Committee and the SEC Issues Committee of the Business Roundtable's Corporate Governance Task Force. Ms. Foran is Vice Chair of the Board of The Better Business Bureau of Metropolitan New York, and also serves on the Business Advisory Council of YAI National Institute for People with Disabilities, as well as the Advisory Committee of the NYU Robert F. Wagner Graduate School of Public Service.

Joe Grundfest

William A. Franke Professor of Law and Business at Stanford Law School; Co-Director, The Rock Center for Corporate Governance; former Commissioner, Securities and Exchange Commission; founder and director, Directors' College at Stanford Law School; principal investigator, Stanford Law School's Securities Litigation Clearinghouse; former counsel and senior economist for legal and regulatory matters at the President's Council of Economic Advisors. An attorney and economist, Professor Grundfest has also practiced law with Wilmer, Cutler & Pickering, and has served as an economist with the Brookings Institution and the Rand Corporation.

Professor Grundfest directs the Roberts Program in Law, Business and Corporate Governance at Stanford Law School. He has served on the New York Stock Exchange's Legal Advisory Board, on the NASDAQ Legal Advisory Committee, on a rules committee of the United States District Court for the Northern District of California, and has been elected to membership of the American Law Institute. Professor Grundfest has received the John Bingham Hurlbut Award for Excellence in Teaching as well as the Associated Students of Stanford University award as the best professor at the Stanford Law, Business, and Medical Schools. Professor Grundfest has been selected as a National Fellow by the Hoover Institution, has been awarded a John M. Olin Faculty Fellowship, and is an Adjunct Scholar of the American Enterprise Institute. Professor Grundfest is admitted to practice in California and in the District of Columbia.

Professor Grundfest holds a Bachelor's degree in Economics from Yale University (1973) and completed the M.Sc. program in Mathematical Economics and Econometrics at the London School of Economics (1972). His Law degree is from Stanford (1978) where he also completed all requirements for a Doctorate in Economics but for the dissertation (1978).

Keith Johnson

Mr. Johnson chairs the Institutional Investor Services practice group at Reinhart Boerner Van Deuren s.c., a Wisconsin-based law firm, where he represents pension funds and other institutional investors on fiduciary, investment, securities litigation and corporate governance program matters. He is also Program Director of the Wisconsin International Corporate Governance Initiative at the University of Wisconsin Law School and teaches corporate governance. He is a member of the American College of Investment Counsel and the National Association of Public Pension Attorneys Emeritus Board.

Mr. Johnson previously served as legal counsel to the State of Wisconsin Investment Board (SWIB) for over 21 years, including seven as Chief Legal Counsel, and headed SWIB's corporate governance, investment legal services and securities litigation programs. While at SWIB, he was a member of the Council of Institutional Investors Executive Board and Governance Committee and was on the Steering Committee of the International Forum of Active Shareowners. He also served as President of the National Association of Public Pension Attorneys and Co-Chair of the organization's Investment and Corporate Governance Section and Securities Litigation Working Group.

Mr. Johnson holds B.A. and J.D. degrees from the University of Wisconsin and is a member of the Wisconsin State Bar and American Bar Association. He regularly publishes and speaks on corporate governance and securities litigation matters.

Linda Kimball

Manager of Investment Responsibility, Stanford Management Company, Leland Stanford Junior University. Linda Kimball has been at Stanford University since 1991, and Manger of Investment Responsibility since 1995. She works with companies and University constituents from trustees to students addressing social and corporate governance issues related to endowment investments. Ms. Kimball is a current member of the National Association of Corporate Directors (NACD) and a founding director, past President and current Chair of the Silicon Valley Chapter of the National Association of Corporate Directors, member of the Council of Institutional Investors and the European Corporate Governance Network, and advisory board member of the Sustainable Business Institute.

Ms. Kimball is an alumna of San Francisco State University where she majored in Social Anthropology. She is also a frequent speaker and panelist on issues related to Institutional Investors Fiduciary Rights & Responsibilities, Corporate Social Responsibility and Investment Responsibility

Rich Koppes

Of Counsel, Jones Day; Director, Apria Healthcare Group Inc.; Director, Valeant Pharmaceuticals International; former Deputy Executive Officer and General Counsel of the California Public Employees' Retirement System; Co-Director of the Executive Education Programs at Stanford Law School; former member of the New York Stock Exchange Board of Governors' Legal Advisory Committee; member of the Advisory Board of the National Association of Corporate Directors (NACD) and the Blue Ribbon Commissions on Board Evaluations and Shareholder/Director Communications of the NACD; former Vice Chairman of the Corporate Counsel Committee of the International Bar Association; founder, past president and current administrative officer of the National Association of Public Pension Attorneys (NAPPA);

Mr. Koppes received his B.A. in Political Science from Loyola Marymount University in 1968 and his J.D. from U.C.L.A. School of Law in 1971.

Bruce Marquand

Bruce Marquand, a Chartered Financial Analyst, joined General Motors Investment Management in 1989. He currently manages two US Large Cap equity, long-only portfolios, co-manages GMIMCo's multi-billion dollar US Large Cap long-only Fund of Funds, is part of the teams managing GMIMCo's global equity market neutral Fund of Funds and its global equity, long-only Fund of Funds, and serves as chairperson for GMIMCo's Proxy Voting Committee. Prior to joining GMIMCo, he served as Senior Vice President for Institutional Investments at New England Mutual Life during 1987-89. He also had a 20 year career at Equitable Life of New York where his final role was Managing Director for Business Development at Equitable's in-house equity management subsidiary where he was responsible for quantitative research, product development, information technology, legal affairs, investment support for Equitable's variable life and annuity products and proxy voting. Mr. Marquand received a BA in Accounting at Michigan State University and an MBA in Finance at the University of Chicago Graduate School of Business.

Glenn Miles

Director, Corporate Governance Research Projects, Program in Law, Economics and Business, Stanford Law School; former Corporate Governance Officer, California Public Employees' Retirement System (CalPERS); founding member, Paris Bourse International Investors Advisory Committee; former Finance Budget Analyst, California Department of Finance.

Mr. Miles graduated with a B.A. from the University of California, Davis, an M.A. from the Johns Hopkins University, and a J.D. from the University of California, Hastings College of the Law in San Francisco. He has also studied international relations and economics at the National Autonomous University of Mexico, the University of Vienna, and the Johns Hopkins S.A.I.S. Bologna Center, Bologna, Italy.

Dan Siciliano

Executive Director, Program in Law, Economics, and Business at Stanford Law School; Director and former Chief Executive Officer, LawLogix Group, Inc.

Mr. Siciliano teaches Corporate Finance, Corporate Governance and Practice, and is the senior Teaching Fellow for the international LL.M. degree program in Corporate Governance and Practice at Stanford Law School. He also serves on the Academic Council of Corporate Board Member magazine as a subject matter expert. Mr. Siciliano, a Truman Scholar, has worked with both public and private organizations including teaching and research at Stanford's Hoover Institute and macroeconomic policy analysis at the Congressional Budget Office in Washington, D.C.

Mr. Siciliano received his BA from the University of Arizona and completed both his graduate fellowship in Economics and his J.D. at Stanford University.

John Wilcox

Senior Vice President and Head of Corporate Governance, TIAA-CREF; former Vice Chairman, Georgeson Shareholder Communications Inc.; Member, International Corporate Governance Network board of governors.

Mr. Wilcox holds a B.A. from Harvard College, where he was a member of Phi Beta Kappa, an M.A. from the University of California, Berkeley, where he studied as a Woodrow Wilson Fellow, a J.D. from Harvard Law School and an LL.M degree from New York University Graduate School of Law. He is a member of the American and New York Bar Associations.

Appendix B: Examples of Fund Governance Best Practices

The following are some organizations that have developed fund goverance guidelines including a one page excerpt from their guidelines and a reference to their websites where one can find the each respective insitution's fund governance documents.

CalSTRS (pg. 27)
http://www.calstrs.com/Newsroom/What%27s%20New/Proposed_Regulations_24010.pdf

Franklin Resources, Inc. (pg. 28)
https://www.franklintempleton.com/retail/jsp_cm/global_nav/company/ethics_conduct.jsp

International Corporate Governance Network (pg. 29)
http://www.icgn.org/organisation/documents/src/Revised%20Statement%20on%20Shareholder%20Responsibilities%20130407.pdf

TIAA-CREF (pg. 30)
http://www.tiaa-cref.org/about/governance/corporate/topics/governance_documents.html

CalSTRS PROPOSED NEW REGULATIONS

Pursuant to Title 1, Division 1, Chapter 1, Article 2, Section 8 CCR,
the entire following text is proposed to be added to the CCR

California Code of Regulations

Title 5. Education
Division 3. Teachers' Retirement System
Chapter 1. Teachers' Retirement System

Article 14. Prohibitions on Certain Campaign Contributions

Prohibitions on Certain Campaign Contributions

24010. (a) No party who engages or seeks to engage in a business relationship for gain with CalSTRS may make any campaign contributions, as defined in The Political Reform Act, valued in excess of $1,000, individually or in the aggregate, in any calendar year, to any person designated in subsection (b) below.

(b) This prohibition applies to campaign contributions made directly or indirectly to, or on behalf of, CalSTRS officers and employees, any existing Teachers' Retirement Board member, the sitting Governor, Controller, Treasurer, and Superintendent of Public Instruction of the State of California, candidates for Teachers' Retirement Board member, and candidates for the offices of the Governor, Controller, Treasurer, and Superintendent of Public Instruction of the State of California.

(c) This prohibition shall apply to any vendor, investment firm, consultant, and any other non-governmental entities, including their partners and executive officers, and shall apply to contributions from others made at the direction of such entities or those parties identified in this subdivision who:

(1) Seek a business relationship with CalSTRS which is expected to generate at least $100,000 annually in income, fees, or other revenue to the business entity; or

(2) Have a current business relationship with CalSTRS which is likely to generate at least $100,000 annually in income, fees, or other revenue to the business entity.

(d) This prohibition shall apply to any third party solicitor who assisted any party identified in subdivision (c) of this section in the solicitation of a business relationship with CalSTRS or the retention of a business relationship with CalSTRS.

(e) For parties defined in subsections (c) and (d) above, the prohibition set forth in subdivision (a) above shall apply to the time period which begins on the date CalSTRS first announces a procurement or search process that could lead to a business relationship which is likely to generate at least $100,000 annually in income, or the date a party identified in

To read this document in its entirety, please visit:
http://www.calstrs.com/Newsroom/What%27s%20New/Proposed_Regulations_24010.pdf

FRANKLIN RESOURCES, INC.

CODE OF ETHICS AND BUSINESS CONDUCT

This Code of Ethics and Business Conduct (the "Code") has been adopted by the Board of Directors (the "Board") of Franklin Resources, Inc. in connection with its oversight of the management and business affairs of Franklin Resources, Inc.

1. **Purpose and Overview**.

(a) *Application*. The Code is applicable to all officers, directors, employees and temporary employees (each, a "Covered Person") of Franklin Resources, Inc. and all of its U.S. and non-U.S. subsidiaries and affiliates (collectively, the "Company").

(b) *Purpose*. The Code summarizes the values, principles and business practices that guide the business conduct of the Company and also provides a set of basic principles to guide Covered Persons regarding the minimum ethical requirements expected of them. The Code supplements the Company's existing employee policies, including those specified in the respective U.S. and non-U.S. employee handbooks and also supplements various other codes of ethics, policies and procedures that have been adopted by the Company or by particular entities within the Company. All Covered Persons are expected to become familiar with the Code and to apply these principles in the daily performance of their jobs.

(c) *Overriding Responsibilities*. It is the responsibility of all Covered Persons to maintain a work environment that fosters fairness, respect and integrity. The Company requires all Covered Persons to conduct themselves in a lawful, honest and ethical manner in all of the Company's business practices.

(d) *Questions*. All Covered Persons are expected to seek the advice of a supervisor, a manager, the Human Resources Department, the Legal Department, the General Counsel of Franklin Resources, Inc. or the Global Compliance Department for additional guidance or if there is any question about issues discussed in this Code.

(e) *Violations*. If any Covered Person observes possible unethical or illegal conduct, such concerns or complaints should be reported as set forth in Section 16 below.

(f) *Definition of Executive Officer*. For the purposes of this Code, the term "Executive Officer" shall mean those officers, as shall be determined by the Board from time to time, who are subject to the reporting obligations of Section 16(a) of the Securities Exchange Act of 1934, as amended.

(g) *Definition of Director*. For purposes of this Code, the term "Director" shall mean a member of the Board.

To read this document in its entirety, please visit:
https://www.franklintempleton.com/retail/jsp_cm/global_nav/company/ethics_conduct.jsp

Endorsed by the ICGN Board for member approval at the 2007 AGM

International Corporate Governance Network:
Statement of Principles on Institutional Shareholder Responsibilities

1.0 Key Considerations

1.1 This ICGN statement sets out our view of the responsibilities of institutional shareholders both in relation to their external role as owners of company equity, and also in relation to their internal governance. Both are of concern to beneficiaries and other stakeholders.

1.2 The ownership of equity carries important responsibilities, particularly due to the voting rights that can influence the way in which a business is conducted. Ultimate owners cannot delegate these responsibilities. Even when they employ agents to act on their behalf, it is up to beneficial owners to ensure that the responsibilities of ownership are fulfilled by those agents.

1.3 While some involved in the complex chain of intermediaries between beneficiaries and issuers have a simple obligation to provide a service, many have an agency function with a principal fiduciary responsibility to generate optimum returns consistent with the time horizon of the beneficiaries.

1.4 Those that represent beneficiaries need to be clear about the objectives of the beneficiaries. This involves careful consideration of key points, including the appropriate balance between short-term return and long-term value. Resources applied to governance and the exercise of votes may generate costs in the short term, but an increasing weight of evidence suggests this will add value in the long-term. The ICGN's Statement on Stock Lending explores aspects of this in greater detail.

1.5 While it is vital that companies ensure shareholders can exercise their rights of ownership, these rights must be exercised responsibly. Moreover, responsible behaviour on the part of shareholders will reinforce their claim to rights. Even where companies refuse the rights of ownership to their shareholders, this does not absolve the latter from seeking to influence the behaviour of the company. Responsible ownership requires high standards of transparency, probity and care on the part of institutions, which may be met by adhering to the principles set out below.

1.6 While practice will vary in detail between national markets, the principles that underlie high standards are constant. The annex to this paper therefore includes examples of how principles have been applied in different markets to provide useful guidance. In addition, the ICGN website provides a bibliography of relevant literature.

1.7 This statement follows on from the ICGN statement of October 2003. The Principles set out here reflect the fact that understanding of the different roles played

To read this document in its entirety, please visit:
http://www.icgn.org/organisation/documents/src/Revised%20Statement%20on%20Shareholder%20Responsibilities%20130407.pdf

B. Fiduciary Duties

The Board of Overseers is a New York not-for-profit corporation. In exercising their powers and responsibilities, to fulfill the Mission, the Overseers must satisfy three fiduciary duties: the duty of care, duty of loyalty and duty of obedience:

1. **Duty of care**: the obligation of trustees to inform themselves fully and carefully with respect to a particular matter, and to act with that degree of diligence, care and skill which ordinarily prudent persons would exercise under similar circumstances in like positions.

2. **Duty of loyalty:** the obligation of trustees, when making decisions, to act without conflict of interest.

3. **Duty of obedience:** the obligation of trustees to ensure that the charitable purpose, or Mission, of the not-for-profit corporation is carried out.

C. Governance Principles

In considering how the Overseers fulfill their roles as Overseers, Board of Overseers Members and CREF Members, these individuals must be aware of, and seek to comply with, several governance principles generally applicable to employees and trustees of the TIAA-CREF Group.

1. **Oversight.** The Overseers exercise, to varying degrees, oversight with respect to TIAA and CREF, providing guidance and advice with respect to any matters that could significantly adversely affect the reputation of TIAA-CREF for value, integrity and trust.

With respect to TIAA, and consistent with the duties of care and obedience in administering TIAA's stock in a way that furthers the Board of Overseers' purpose, the Overseers must inform themselves of the major developments and risks confronting TIAA. This enables them to understand and provide oversight of significant corporate events such as restructurings, succession planning for the Chief Executive Officer of TIAA and significant legal or compliance issues, as well as competitive, financial and reputational risks of which senior management of TIAA and TIAA Trustees are aware.

As CREF Members, the Overseers approve changes in governance documents, consult on the consideration of nominees for election as CREF Trustees (to the extent permitted by the 1940 Act) and make suggestions regarding such nominees to CREF's Nominating and Governance Committee (See IV.C.2 "Governance Structure—The Overseers' Role as CREF Members—Responsibility").

To read this document in its entirety, please visit:
http://www.tiaa-cref.org/about/governance/corporate/topics/governance_documents.html

About the Arthur and Toni Rembe Rock Center for Corporate Governance:

The Arthur and Toni Rembe Rock Center for Corporate Governance, a joint initiative of Stanford Law School and the Stanford Graduate School of Business, was founded in 2006 to advance the practice and study of corporate governance and become an important voice in the debate over governance policy, both domestically and internationally. The Rock Center's home page is located at www.law.stanford.edu/program/centers/rcfcg.

Produced by the staff of the Stanford Program in Law, Economics, & Business in cooperation with the Stanford Institutional Investors' Forum, 2007.

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or visit: www.law.stanford.edu/ClapmanReport