SHARE | Shareholder Association for Research and Education

19 December 2002

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities Commission
Manitoba Securities Commission
Ontario Securities Commission
Securities Administration Branch, New Brunswick
Office of the Attorney General, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Department of justice, Government of the Northwest Territories
Registrar of Securities, Government of Yukon
Registrar of Securities, Legal Registries Division, Department of Justice, Government of Nunavut

c/o John Stevenson
Secretary
Ontario Securities Commission
20 Queen Street West, 19th Floor
Box 55
Toronto, Ontario M5H 3S8

Denise Brosseau
Secretary
Commission des valeurs mobilières du Québec
800 Victoria Square, Stock Exchange Tower
P.O. Box 246, 22nd Floor
Montréal, Québec H4Z 1G3

Dear CSA Representatives:

Re: National Instrument 81-106 and Companion Policy 81-106CP

Thank you for the opportunity to provide comment on proposed National instrument 81-106 and Companion Policy 81-106CP on behalf of the Shareholder Association for Research and Education (SHARE).

SHARE is a national non-profit organization originating within the labour movement working with institutional investors, primarily pension plans, to promote responsible

investment practices through research, educational activities, and advocacy. Our affiliates currently administer assets of more than $2 billion.

SHARE commends the CSA on its efforts to harmonize and streamline continuous disclosure requirements for "investment funds". Continuous disclosure is a necessary prerequisite to ensure that both retail and institutional investors are able to obtain the information necessary to make informed and prudent investment decisions. From SHARE's perspective working with Canadian pension plans, NI 81-106 has important implications in the context of defined contribution pension plans. We believe that it is good public policy to provide members of such plans with the maximum level of disclosure possible from investment funds in order to make informed investment decisions.

We take this opportunity to comment on certain elements of NI 81-106, specifically the disclosure requirements with respect to proxies (Form 81-106F1, Part B, Item 1.2(h)), the scope of disclosure of material risks, and delivery requirements for financial statements and management reports.

Disclosure of Proxy Voting Guidelines and Records

Item 1.2(h) of Part B of Form 81-106F1 accompanying NI 81-106 will require that all investment funds summarize in the Management Discussion of Fund Performance (MDFP) how they voted on matters, other than routine business, with respect to issuers of portfolio assets held by the fund.

We commend the inclusion of this requirement in NI81-106, but submit that it must go further.

The voting rights attached to securities are valuable assets. The Association for Investment Management and Research (AIMR) asserts in its *Standards of Practice Handbook*[1]:

> "Actively exercising [voting] rights through corporate governance may be an effective way of enhancing portfolio value. Not exercising these rights ignores a valuable ownership right that could be managed for the benefit of the portfolio and, in certain accounts, may constitute a dereliction of legal and fiduciary responsibilities to clients."

This view has been affirmed by the federal Office of the Superintendent of Financial Institutions[2], the United States Department of Labor[3], the UK Myners Report (March 2001)[4], and the Technical Committee of the International Organization of Securities Commissions (IOSCO)[5].

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[1] AIMR, *Standards of Practice handbook – the Code of Ethics and The Standards of Professional Conduct with commentary and interpretation* (8th ed.). Available at http://www.aimr.com/standards/ethics/code/index.html.

[2] Office of the Superintendent of Financial Institutions. *Guideline for the Development of Investment Policies and Procedures for Federally Regulated Pension Plans.* Ottawa: OSFI, April 2000, endnote 4, Appendix I, section I.6.6. Available at www.osfi-bsif.gc.ca/eng/pensions/guidelines/pdf/penivst.pdf.

[3] Department of Labor Pensions and Welfare Benefits Administration, *Interpretative Bulletin 94-2* (29 July 1994).

[4] HM Treasury, *Institutional Investment in the United Kingdom,* Paul Myners (6 March 2001).

[5] Report of the Technical Committee of the International Organization of Securities Commissions, *Collective Investment Schemes as Shareholders: Responsibilities and Disclosure* (IOSCO, May 2002).

Increasingly, Canadian and American managers now voluntarily disclose proxy voting policies and voting records on-line. Ethical Funds Inc. was the first Canadian investment fund to disclose its guidelines and voting record on-line.[6] Other Canadian managers, including Real Assets Investment Management Inc. (www.realassets.ca), disclose their proxy voting guidelines on their website.

In addition to mutual funds, a host of pension plans, including but not limited to the Ontario Teachers' Pension Plan, Ontario Municipal Employees' Retirement System (OMERS) and the California Public Employees' Retirement System (CalPERS), disclose their proxy voting guidelines and voting records on-line to plan members.

The disclosure of proxy voting guidelines and voting records by mutual funds and other institutional investors cited here is not limited to non-routine matters. Indeed, the election of directors and the appointment of the auditor, both traditionally viewed as routine items of business, have been at the centre of recent corporate governance controversies in the United States and Canada. The funds noted above that provide voluntary disclosure of their proxy voting guidelines and voting records do not distinguish between "routine" and "non-routine" matters.

Based on the above observations, we urge the CSA to amend Form 81-106F1, Part B, Item 1.2(h)) to require investment funds to disclose, at a minimum, where they voted contrary to management's recommendation and where they deviated from their own guidelines. It is presumed that the purpose of the proposed disclosure requirement is to provide investors with a comprehensive picture of how mutual funds voted their proxies. With respect, this objective is not satisfied by the proposed provision. Requiring investment funds to indicate in the MDFP instances where they voted against management's recommendation and contrary to their own guidelines provides investors with a complete voting record. As stated, disclosure of votes on non-routine matters is insufficient. By disclosing votes contrary to management's recommendations, investors can compare this information against the complete list of proposals entertained by a company in a given year (provided on SEDAR) and extrapolate the funds entire voting record with respect to that company. By identifying votes that deviated from the fund's proxy voting guidelines, investors can assess how a fund voted on a particular issue across a range of companies.

This variation of the disclosure requirement will not undermine the objective of containing the length of the MDFP any more than the existing proposed provision. Proposals on non-routine matters are increasing each year and in many cases exceed the number of proposals where a manager voted contrary to management or its proxy voting guidelines.

In addition, all investors should be afforded the ability to view the mutual fund's entire proxy voting record upon request. In most instances, this can be facilitated easily by disclosure on SEDAR or the firm's website.

[6] See www.ethicalfunds.com/do_the_right_thing/sri/shareholder_action/proxy_voting_report.asp.

SHARE's Recommendation: Amend NI 81-106 to require investment funds to disclose where the fund votes against management's recommendation and any deviations from the fund's proxy voting guidelines on both routine and non-routine matters, and to make a copy of the fund's proxy voting record available to investors on SEDAR and in hard copy upon request.

Implied in the above recommendation is the need for investment fund's to disclose a summary of their proxy voting guidelines. In addition to allowing investors to assess how a fund voted its proxies, disclosure of proxy voting guidelines provides investors with knowledge of the approach that fund managers take to voting proxies under their discretion. Simply providing voting records after the fact is insufficient. Consistent with the proposed SEC Rule, *Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies*, investment funds should be required to make a copy of their proxy voting guidelines available to all investors upon request. In most instances, this could be facilitated easily by disclosure of the guidelines on SEDAR or the firm's website.

SHARE's Recommendation: Amend NI 81-106 to require investment funds to provide a summary of their proxy voting guidelines in the MDFP and indicate that a copy of the guidelines are available on SEDAR or in hard copy at the investor's request.

Scope of Disclosure of Material Risks

In response to the CSA's specific question on the disclosure of risk and volatility, SHARE strongly recommends that NI 81-106 provide guidance on what constitutes material risk to be disclosed to investors. Specifically, investment funds should be required to provide disclosure on the extent to which they consider, if at all, social, environmental, ethical and labour rights criteria when making investment decisions.

This proposed reform is modeled on disclosure requirements enacted as part of the Australian *Financial Services Reform Bill 2001,* which requires all financial service providers to disclose the extent to which they take into consideration labour rights, social, environmental and ethical considerations when making investment choices.

There is increasing empirical evidence linking corporate social and environmental performance, investor risk and shareholder value.[7] While the insurance industry and banks have incorporated environmental criteria into their valuations for years, the retail and institutional investment sector have been slow to do the same. However, investors are starting to appreciate the impact of corporate social and environmental practices on investment risk and shareholder value, evidenced by increasing investor interest in socially responsible investment vehicles and support for Canadian and American shareholder proposals addressing such issues.

From an administrative perspective, we submit that any additional burden imposed by such a requirement will be minimal and offset by the benefit to the investor client.

[7] See e.g. Ronald M. Roman, Sefa Hayibor, and Bradley R. Agle, "The Relationship Between Social and Financial Performance," *Business and Society* 38, no.1 (March 1999): 109.

SHARE's Recommendation: Amend NI 81-106 to require mutual funds to disclose in the MDFP the extent to which they take into consideration social, environmental, ethical and labour rights when making investment decisions.

While we appreciate that the MDFP should provide a concise summary of fundamental investment objectives and strategies, we caution against recommending a preferred length. The consolidation of such information in one policy and one document presents efficiencies to both funds and investors, however our concern is that suggesting a preferred length could result in some investment funds sacrificing significant disclosure to investors.

SHARE's Recommendation: Amend NI 81-106 to remove limits on the length of the annual MDFP.

Finally, we take this opportunity to encourage all CSA members to raise the issue of disclosure of proxy voting guidelines, proxy voting records and social and environmental criteria applied to investment selection and retention by all institutional investors, specifically pension funds. Pension funds do not fall under the CSA's purview, however we see NI 81-106 as an opportunity to encourage enhanced, uniform continuous disclosure by all institutional investors. Disclosure requirements imposed on one class of fiduciaries should by applied uniformly to all. Recent survey data on proxy voting practices by Canadian investment managers obtained by SHARE indicate a significant variation in how proxies are voted on behalf of institutional clients (see SHARE's *2002 Key Proxy Vote Survey* at www.share.ca). This information should be made available to all plan members.

The Canadian investing public deserves the same level of disclosure with respect to all their investments. We therefore urge the CSA to take the opportunity when releasing NI 81-106 to raise the issue of similar disclosure of pension plans with the federal Minister of Finance, provincial ministry's responsible for provincially-registered pension plans, and members of the Canadian Pension Supervisory Authorities (CAPSA).

SHARE looks forward to the CSA's deliberations on NI 81-106. Should you require any clarification of the points raised above or additional supporting information, please do not hesitate to contact me at the address provided below.

Yours truly,

[Giil Yaron]

Gil Yaron
Director of Law & Policy