ETHICSCAN CANADA LTD.

21 May 2004

Secretary
Ontario Securities Commission
Toronto, Ontario

Secretary
Saskatchewan Financial Services Commission
Regina, Saskatchewan

Submission on Draft Governance Policy and Reporting Instrument

Dear Sirs:

Attached please find a submission from our organization, accepting your invitation to comment upon the proposed governance policy and reporting instrument submitted for public response this spring. Following that Call for Comment from your organizations, EthicScan Canada Limited voluntarily initiated invitations to, and co-hosted, two multi-stakeholder roundtables in March 2004 in Toronto and Ottawa on this topic.

Overall, EthicScan is pleased to note that ethics is receiving its due as a consideration of, and requirement for, good governance. As envisaged in the proposed policy and reporting instrument, companies are expected to report on ethics in much the way they would Board structures. Regrettably, there are three problems with this approach. One, there is no evidence that having a code warrantees profitable or ethical outcomes. This is consistent with research findings denying any link between governance structure, independent directors and Board structure, on the one hand, and financial returns, on the other. Two, an ethics code is not a prerequisite for ethical actions. An integrated set of ethics guidance, training and reinforcement tools, supported by ethical executives and managers, however, is. Three, companies and civil society organizations need regulators and professional bodies like yourselves to champion and mandate suitable ethical inoculation research, education and tools like ethics audits, accountability statements, and social, ethical and environmental risk analysis (S.E.E. Risk Analysis). Such proactive tools would help allow executives, directors and employees of conscience to report and act upon concerns or suspected wrongdoing.

With this in mind, EthicScan has tabled twenty recommendations which we commend to your attention. We thank you for the opportunity to be heard on these guidelines and would be pleased to provide clarification, if required.

Yours truly

David Nitkin
President

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Submission on Draft Governance Policy and Reporting Instrument

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1. Terms of Reference

You have requested comments from the public on *Multilateral Policy 58-201* and *Multilateral Instrument 58-1-1*. Initially, four questions were specifically raised by the OSC and SFSC for comment:

"Will these initiatives provide useful guidance to issuers?"
"Will these initiatives provide meaningful guidance to investors?"
"Would disclosure be more meaningful if issuers were required to describe categories of governance principles… rather than best practices described in the policy?"
"What will be the effect on market participants, including investors and issuers, of our publishing best practices in Canada?"

A fifth question was posed asking about implications for income trusts.

Our analysis of the policy and instrument Guidelines contains the following observations:

1. the content for desirable reporting seems to be based upon certain supposed benefits of ethics and governance tools, rather than any empirical research on the combination of leadership and organizational methods that enhance good ethics or good governance

2. the justification for extended reporting reflects top-down, compliance-based, legalistic. command and control thinking, rather than integrity or ethically-based standards that go beyond legal compliance. Ethics, which isn't synonymous with compliance, incorporates but transcends the letter of the law.

3. little mention is made of the relationship of these recommendations to the reputation of capital markets, public opinion, the rights of pensioners, the strengths and limits of self regulation, or minority shareholders

4. determination of best practice organizational assessment is deemed to be wholly internal, with no reference to independent accounting, auditing or verification

5. little attempt is made to explain or justify an underlying assumption that best practice Board structure mechanisms in the policy and instrument will influence corruption, insider trading, poor performance, risk management, or lawsuits

6. the terms of reference for comment address ethics codes and governance norms, but say nothing about organizational due diligence, fiduciary responsibility, democratic practice, corporate candor and accountability. Are the two norms the right ones to identify, support or reinforce as best practice rules?

7. no question is raised about whether or how other, alternative proposed norms, practices, tools or disclosures could be more beneficial to the integrity of markets, and coherence of regulatory approaches, both domestic and international. Little explicit mention is made of accountability, transparency, or corruption

8. little or no consideration is given to the adverse consequences of the proposed approach you adopt which says that guidelines aren't mandatory, but reporting is

9. no explicit mention is made of the desirability of reducing filers' or issuers' paper burden by harmonizing Canadian requirements with those in other jurisdictions

2. About Ourselves

EthicScan is Canada's oldest, largest, and well-respected corporate responsibility research house and full-service ethics consultancy. Our mission is to empower individuals, businesses and organizations with the tools and research to apply their values across life's daily challenges— be they training, procurement, consuming, partnering, ethical assurance and investing, or simply managing with integrity.

The practice was established as a fee-for-service business in 1989 in Toronto by our founder, David Nitkin. From its inception, EthicScan has emphasized original independent research into the social, labour and environmental performance of 1500 Canadian organizations in order to provide resources, tools, case studies and advice. This information and experience has empowered many individuals and organizations to recognize, promote, and reinforce ethical decision-making.

Today EthicScan has grown to a complement of consultant associates, contract researchers, and an editor, with operations in Toronto, Montreal, Edmonton, Truro and Kitchener. Our organization produces books, videos, integrity tests, Partnership Screening reports, corporate ethics codes, and a highly valued journal, *The Corporate Ethics Monitor,* as well as maintains the EthicScan Corporate 1500 DataBase™. We offer a range of programs, including Safe Partnering, Corporate Accountability and Responsibility Leadership, Integrity Testing, and Ethics Do Diligence™.

EthicScan Canada has three product or service areas:

o Consulting: Ethics Guidance, Training and Reinforcement

o Research: Corporate and Organizational Responsibility Research

o Education: Ethical Investing, Partnering and Screening

Our consultant associates are members of The Ethics Practitioners' Association of Canada. All subscribe to EPAC's *Ethical Standards for Members*, Core Competencies and *Guidelines on Standards of Practice*.

To explore our Consulting Services Web-site, see <www.ethicscan.ca>. To receive literature about the Corporate Accountability & Responsibility Leadership ™ (CARL) Program, the Safe Partnering Service (Bronze or Silver) Service, or the Do Diligence Program ™ (Ethics Advice & Social Audit) in co-operation with Family Services), contact the EthicScan office. To view changing expectations about corporate accountability, see <www.pental.ca>.

Bios for associates in Toronto, Montreal, Waterloo, Barrie, Victoria, Hamilton, Truro, and Edmonton are available for

Remy Beauregard	Jane Garthson	Suzanne Jackson	Eric Litwack
Rick Martin	Gay Miller	David Nitkin	Joan Sanger
Paul Pellizzari	Vincent di Norcia		

3. Ethics Research and Recommendations

Directors, and the corporate governance they oversee, are under stress because the perceptions and legal framework in use are out of step with reality. A Board of Directors cannot entirely delegate management of the ethics of a corporation to the management team they hire. Nor can they ignore mechanisms that would encourage independent assessment of ethical performance, including early and regular identification of organizational vulnerabilities. Directors must be aware of potential ethical risks and make sure that the corporation is adequately protected. Regulators, shareholders and the public have a vested interest in ensuring that this takes place, even if conclusions about the how's and what's aren't completely certain.

One positive outcome of all the attention that ethics and governance have been getting in the past couple of years is that there has been an upswing in real research into Boards. This includes university-based research into accountability, financial performance, and reputation risk. Certain recent groundbreaking reports raise serious questions about the implicit assumption that Board composition, independence and structure have anything to do with building a better or more profitable organization.

- James Gillies and Richard Leblanc, of York University, published research in the *Ivey School of Business Journal* (September/October 2003) dealing with "good governance" initiatives such as separating the positions of CEO and Chair, decreasing Board size, and increasing the number and percentage of independent directors on a Board. They conclude that there is "absolutely no evidence linking Board structure and specifically director independence to the financial success of firms". Indeed, "nearly two decades of research find little evidence that Board independence enhances Board effectiveness. Studies have however found a negative effect."

- David Nitkin and Paul Pellizzari examined data on 375 companies in the EthicScan Corporate 1500 DataBase in *The Corporate Ethics Monitor* (September 2000). They concluded that, over the last decade, "Structurally, in terms of enhanced ethical management, there has been some expansion of ethics codes, both in number and breadth of topics. Likewise, there is progress in the integrity-focused activities and training of compliance officers, consumer affairs professionals and ombudspersons, as well as expansions of toll-free consumer and whistle-blower complaint services. Corporate experimentation with voluntary social and environmental reports, triple bottom line accounting, and community engagement is less encouraging."

In this light, then, what can be observed about the policy and instrument guidelines:

1. they deal with only one instrument of ethics guidance, and one instrument of ethics training, and say almost nothing about reinforcement or the considerable corpus of other, professionally accepted, ethics guidance and training mechanisms

2. no normative reference is introduced requiring the issuer to report the date it adopted its existing code or how frequently that ethics code is updated. Research shows the importance of not just adopting a code but regularly updating it

3. the proposals make no distinction between an ethics code and a code of business conduct—the two are different from each other and from other, arguably more effective, mechanisms like a corporate smell test, sniff test, or updatable ethics Q&A manual

4. the policy and reporting instrument contain no reference to an integrated ethics program, including an ethics code and related policy suite, being reviewed by an independent professional, such as a lawyer, accountant, ethicist or other EPAC professional

5. no mention is made that the ethics code should apply to all business units and subsidiaries

6. no mention is made that the content of an ethics code be required to address what to do internationally when business practice standards are different. Does the company adopt "home" rules, for example, if no or inferior national/local laws exist?

7. there are no norms provided in the important area of whistle blower protection—best practice addresses not only this mechanism but also protection during an investigation for both the employee of conscience (the blower) and the alleged problem (the bad seed employee)

8. no mention is made that an ethics code should be clearly communicated throughout the supply chain, including contractors, agents, facilitators, suppliers and others

9. no mention is made of ongoing integrity education for staff, or of ethics training for directors beyond just an initial orientation phase

10. no mention is made of independent diagnostic and induction tools like ValueScan (Pental Consulting) or S.E.E. Risk Analysis to give employees, directors and managers an opportunity identify weaknesses

11. no mention is made of independent diagnostic and reinforcement tools to assess director and Board effectiveness

12. protection of corporate information in an ethics code is not fully defined: should it address not only corporate secrets and client data but also employee data privacy?

13. the policy and reporting instrument make no mention of industry association norms and their relation to corporate codes

14. is it not best practice that ethics codes be translated into languages spoken in host communities? Why would this be left to individual choice?

Structures like ethics codes alone will not warrantee ethical behaviour. Where is identification or evidence that ethical leadership among executives and directors is needed? Sean Quinn, one of EthicScan's directors, comments, "At the risk of being repetitious, when I think of strengthening corporate ethical performance I usually default to one main priority. All companies should have a senior executive responsible for the "ethical portfolio" and this executive should be "qualified/licenced. Ideally this ethics officer could become "qualified" by taking a recognized course."

He goes on to say, “In the same way a CEO, CFO, COO and CIO are responsible and accountable for defined portfolios, one of these officers (or another) should also be responsible/accountable for ethical performance. My simplified take is that it's easy for a corporate ethics policy statement to sit on a shelf. Whereas if someone's arse is on the line to perform and hit ethical targets it helps to measure performance.”

Ideally everyone should have ethics as part of their job description. In practice, if its everyone’s responsibility, then it is no-one’s. Canadian corporations need a professional ethics officer, one whose responsibilities go beyond governance to address corporate responsibility in such areas as health and safety, environment, reputation, and supply chain.

The symbiosis of ethical leadership and orientation, on the one hand, and best practice tools, education, practices and structures, on the other, is essential. Both are mandatory. A legalistic approach to mandating ethics—like those proposed in the United States-- all too often encourages accountants, auditors, “bad seed employees”, and CFOs to circumvent those roles. Contrariwise, governance principles without specificity – like those contemplated in these guidelines-- are recipes for abuse, both corporate and individual. Without ethics officers and rules like ethics codes, the “bad seed employee” can argue that, if ethical requirements are important, why aren’t they mandated and codified?

Guidelines must be predicated upon performance or outcome-based research, They must address the executive culture making decisions as well as effective ethics guidance, training and reinforcement tools. Likewise, mandating the reporting of a code of ethics in the absence of Canadian corporate experience about what constitutes a good code, and how to monitor and reward compliance, is seriously insufficient.

Reference: David Nitkin, “Ethical Engagement,” in *The Corporate Ethics* Monitor (November-December 2000) vol 12, issue 6

Reference: Irwin Fefergrad, “Boards, auditors and independent directors,” in *The Corporate Ethics Monitor* (Nov-Dec 1994) vol 6, issue 6

Reference: Len Brooks, “Corporate social responsibility: The next stage,” in *The Corporate Ethics Monitor* (Jan-Feb 2001) vol 13, issue 1.

Reference: David Stewart-Patterson, “Governance, Ethics and Accountability,” in *The Corporate Ethics Monitor* (September-October 2002) vol 14, issue 5.

Reference: Ed Waitzer, “Governance, Ethics and Regulatory Reform, “in The Corporate Ethics Monitor (July-August 2003) vol 15, issue 4.

A review of these articles, observations, references and organizational ethics induction research leads to the following recommendations:

Recommendation One: The regulator should require issuers to report upon their ethical management structure as well as use of specific, integrated and comprehensive, ethics and governance tools

Recommendation Two: The regulator should mandate that each issuer designate a chief ethics officer for the organization, and require professional training for that executive.

Recommendation Three: The regulator should provide meaningful education, support, recognition and resources in terms of best practice for organizational ethics guidance, training and reinforcement

Recommendation Four: The regulator should provide meaningful guidance in terms of best practice ethics codes. Such practices could include that such business practice conduct codes are routinely updated, apply to all business units, explicitly address variations in international morality and laws depending upon jurisdiction, be the basis for ongoing employee training, and be translated into the language of local usage. Where these best practices aren't followed, reasons shall be required.

Recommendation Five: The regulator should provide useful guidance in terms of a recommended set of independent mechanisms that support assurance, accountability and transparency

Recommendation Six: Until and when a national securities system is in place, provincial and territorial securities bodies should sponsor ongoing multi-stakeholder research and dialogue on effective means to enhance faith on the part of investors, insurers, employees, financial planners and others in our capital markets

Recommendation Seven: Until and when a national securities system is in place, provincial and territorial securities bodies should commit themselves to implement governance policies and principles that link accounting and auditing standards, legal compliance, forensic standards, and anti-corruption initiatives with corporate responsibility and accountability

4. Governance Research and Recommendations

Should some or all Board directors be entirely and truly independent? Popular business press articles and literature say Yes. In the current policy and reporting instrument proposals, the regulator also says Yes. But the proposals have two flaws. First, they assume that director independence will warrantee good financial and ethical performance, without any justification in terms of evidence or research support. Second, the proposals fail to discuss how corporate issuers', and their Boards, will or could have composition, personnel, ethical orientation, and decision-making processes that address the needs and voice of shareholder, non-shareholder and public interest constituencies

A corporate CEO generally nominates and influences decisions about invitations to many or all of the directors who sit on his or her Board. Many may be friends who are executives that sit on one another's Boards. The CEO takes the initiative of determining their compensation, other perks, and the agenda of Board meetings. Their role is seen as expert advice and advice when called upon, rather than as an independent force in policy setting.

Directors rarely are knowledgeable about suppliers, customers, employees, sub-contractors and the communities in which the company operates. One consequence is a limit on diverse viewpoints on the Board. Another is the muting of opinions from non-shareholder constituencies. Yet another consequence is the lack of unedited, broad-based information about activities or problems within the corporation. The practice of appointing union leaders to one or two seats on corporate boards in Europe is uncommon in Canada.

In sum, the breeding of current directors is narrow and harmful to good governance. To combat such in-breeding and enhance the opportunity for independence, many observers argue that every public company should be required to have decisions made by a Board, the composition of which is entirely independent.

The current policy and instrument have a history. The Ontario Securities Commission initially produced a Dey Report in 1994, and updated it in 1999. The current guidelines maintain this framework, which champions principles, self regulation, and a reluctance to encourage or accept independent assessment. The logic seems to be that, if individual principles about good governance are appropriate, then adding individual ethics ones could only be better. The limitation of good governance considerations to directors and shareholders as well as the failure to address good governance throughout the organization —executive, management and individual workers— as well as to its partners and other stakeholders, is a cause of serious concern.

The proposed approach to governance isn't supported by either recent research or performance observations:

- Yvan Allaire and Mihaela Firsirotu present research in a C.D. Howe Institute paper directed toward "fiduciary governance" as a new orthodoxy. They observe that, for 177 companies ranked in the ROB *Report on Business* ratings, "F rated companies outperformed all other companies, closely followed by companies with a C grade. They conclude that, "the better Board independence, the poorer the performance."

- Jeffrey Gandz, of the University of Western Ontario, speaking at an ICORM risk management annual conference in 2004, noted that there was no correlation between good ethics, favourable financial returns, and companies in the second annual report on governance posited by the Canadian Coalition on Good Governance

In this light, then, what can be observed about the policy and instrument proposals, and more specifically about governance best practice:

1. the proposals address employees, management and the Board, but not supply chain partners, unions, host communities, and other ethics code- and code of conduct- related stakeholders

2. if governance standards and ethics codes are required of publicly-traded issuers, why not extend this to investment funds, investment companies, and investment trusts, as well as bond issuers like governments and airport authorities?

3. the discussion of Board director composition or competency is narrow: for example, why is there no mention is made about whether it is desirable or not to have women, worker representatives, minorities, or host communities represented on a board?

4. is it not best practice to limit term of consecutive reappointment of a director?

5. is it not best practice to have non-financial criteria part of a CEO's performance criteria?

6. is it not best practice to have separate votes on individual directors?

7. it is not best practice to require an annual S.E.E. Risk Analysis?

8. is it not best practice to have a corporate governance or corporate responsibility committee of the board?

9. is it not best practice to require directors to have liability insurance?

10. is it not best practice to require directors to search out advice from staff and outside experts when necessary?

Neither independent directors nor Board effectiveness measures, by themselves, will warrantee good governance or superior rates of return. Moreover, the proposed policy and reporting instrument fail to identify many elements of good governance best practice for Boards.

What about conscious efforts by management to set aside ethical rules in order to do business? Our consultants recommend that employees not be permitted to violate ethical norms. Where any such violation is contemplated, this should remain a corporate decision. If a bribe or facilitation payment is made, that violation should be left to senior management or executive committees to implement.

In EthicScan's consulting practice, we stress that management committees authorize facilitation payments, not line employees. Likewise, Boards should have the obligation to oversee or review decisions that violate ethical norms. The Board of directors should have the right and responsibility to monitor ethics decisions by executives, taking the liability of setting aside an ethics code out of the hands of individual employees, and demonstrating that no-one over-rules the Board.

Reference: Joanna Gualtieri, "Accountability within Government," in *The Corporate Ethics Monitor*, (January-February 2001) vol 13, issue 1.

Reference: Len Brooks, "Enron's Governance: ZZZ", in *The Corporate Ethics Monitor*, (January-February 2002) vol 14, issue 1.

Reference: Mark Walsh, "Accounting Standards—Principles or Rules?", in *The Corporate Ethics Monitor*, (March-April 2002) vol 14, issue 2.

Reference: Ed Waitzer, "Back to Basics—Trust." In The Corporate Ethics Monitor, (July-August 2002) vol 14, issue 4

Reference: Glorianne Stromberg, "Perspectives on Corporate Governance," in *The Corporate Ethics Monitor*, (May-June 2003) vol 15, issue 3.

A review of these articles, observations, references and governance research leads to the following recommendations:

Recommendation Eight: The regulator should support requirements that the issuer demonstrate in detail that, in its Board composition and decision-making, it addresses the needs and voice of all stakeholders, including non-shareholder constituencies

Recommendation Nine: The regulator should recognize the right and responsibility of Board directors to monitor ethical decisions by executives, taking the liability and decision to violate the ethics code out of the hands of individual employees, and demonstrating that no-one over-rules the Board.

Recommendation Ten: No individual employee should have the right to waive an ethics code requirement, although the executive committee and Board may do so, but only if they explain the reasons for that decision.

Recommendation Eleven: The regulator should provide meaningful guidance in terms of best governance practice, for the use of Directors, lawyers, insurers, accountants, auditors, and others. Such practices could include seeking outside advice, regular assessment of individual and group performance, individual (rather than slate) nomination of directors, and reasonable limits on consecutive appointments. Where these best practices aren't followed, reasons shall be required.

5. Organizational Due Diligence Research and Recommendations:

Will the current proposed policy and instrument encourage fiduciary due diligence within companies? In its written submission to the Broadbent Commission, in 2001, EthicScan Canada suggested that organizations can, and should, be encouraged to do the right thing. What was needed, it was argued, were requirements, inducements, recognition and appropriate rewards for companies, management and staff. This includes systems to monitor, assess and manage ethical responsibilities, including an annual risk-based due diligence report to be presented to the Board.

In 1991, and reinforced thereafter, the U.S. Sentencing Commission issued important guidelines that reduce penalties for organizations with substantial ethics guidance and compliance programs. The principle was that a company receives a lower penalty for the action of a renegade or "bad seed" employee, if it can demonstrate that appropriate ethics guidance, training and reinforcement program was in place. In effect, penalties were significantly reduced for companies which had an effective ethics program.

The regulatory environment is Canada pales by comparison, and is attested to by a continuing string of stock frauds, improper sales activities, insider trading and related high profile cases. Unlike European and American jurisdictions, Canada has not effectively nurtured the notion that organizational due diligence should mitigate or decrease liability if a corporation has in place an effective legal compliance program.

According to performance data in the EthicScan Corporate 1500 DataBase, many companies do not have a chief ethics officer, or a structure to train and reinforce staff on the enterprise's code of responsible business practices. This includes companies in the energy, mining and metallurgy, forestry, and chemicals sectors, where there may be long term multi-billion dollar liabilities from contaminated waste sites or untreatable waste by-products. Few Canadian companies have experimented with value-at-risk models for determining risk in capital adequacy, or dollars for reclamation and rehabilitation. Effective integrity programs may support a due diligence defence for organizations charged with civil or criminal activities or non-compliances—but for the fact that Canadian regulators rarely address due diligence in their definition of good governance.

Canada has an undeserved reputation internationally for responsible regulatory behaviour. Critics argue that existing environmental, food, water, health inspection, consumer labelling, and other rules are not being enforced. Advocates see government as absenting itself from responsible regulation or declining to impose additional regulatory or reporting burdens on the private sector.

The pendulum shift away from government inspection toward industry self-regulation has been accompanied by a growing number of preventable diseases and deaths. Traditional independent monitoring, inspection and enforcement are systematically being under-funded, and this is a source of growing consumer or public unease. Canada's major exports (such as genetically-modified wheat, clear cut forest products, and hydro-electric power sourced in contested indigenous land claim areas) face growing threats of exclusion in European and Asian markets. These countries are adopting stricter, non-economic (that is, social and environmental) trade barriers. Insurers, host communities, worker associations and the environment as well as traditional exporters are all constituencies or stakeholders that aren't well served by this trend.

There is evidence that citizens here and elsewhere are sceptical about the increasing phenomenon of self-congratulatory reports of a company's operations, typically available as glossy Community or Sustainable Reports. They want criminals— including those in government and Crown corporations— to be held accountable for corruption and malfeasance. The public across OECD countries make it clear in the *Millennium Poll* that companies should have an obligation beyond just the bottom line.

Canada's emerging corporate governance framework needs to better address this expectation, and provide for effective independent monitoring of management's conduct. There is an alternative to a steady acceleration of piecemeal regulations and intrusions in the private sector by the courts and legislators in the area of transparency and managerial accountability. It involves compulsory, proactive reporting by large companies and institutions to key publics and constituencies. This means more explicit requirements for organizations to explain how reputation risk management, market integrity, international competitiveness, democracy, and other accountability topics are being addressed.

Corporations, unlike individuals, have unique rights of birth, death, rebirth and reduction of personal liability—rights that carry responsibilities in terms of transparency and accountability. Companies that receive protection in law from the process of incorporation should have a companion responsibility to disclose compliance with national laws and regulations, international standards, and constituency expectations. . Why is it that Canadian companies, for example, aren't routinely required to report in annual reports and AIFs when they are guilty of transgressing health, safety, labour, fair competition or environment rules?

Likewise, why would we expect accountants and auditors hired by companies not to have principal allegiance to their client or employer? When questioned in ethics classes, such professionals repeatedly acknowledge that their ethical obligations are, first, to partners; second, to shareholders and the client; and only third, to the public, regulators, and minority shareholders. The field of independently conducted and verified social audits holds great promise for encouraging auditor independence, corporate transparency, organizational accountability, as well as informed democratic discourse in markets.

In this light, then, what can be observed about the proposed policy and reporting instrument:

1. the proposed waiver of an ethics code in favour of a corporate officer is problematic, specifically in terms of application, as well as disclosure— the issue is what if illegal behaviour is sanctioned (and the concern is self incrimination)

2. the regulator may exempt the ethics code requirement— why is there no justification and limitation of the allowable circumstances, if this is a regulator's right?

3. the definition of "material" relationship is weak: it does not address familial, financial influence, nor measure in the eyes of public, rather than narrowly the Board

4. corporate structure, rather than corporate behaviour, is addressed, despite the fact that one "bad seed employee" (and it's typically a senior person) can "kill" a reputation or a business

5. it is unclear what is the meaning of "regular Board assessments": there is no reference to independent assessors or verification

6. there is a need to integrate governance with themes like sustainability, accountability and corporate responsibility

7. there is a need for better research into the relationship between board/director structure, decision-making and competence, on one hand, and financial and social performance, on the other

8. the meaning of "independence" isn't defined: it's a decision left to the Board, rather than public impression or accountability

9. the meaning of "separate meetings" of independent directors is uncertain — what does best practice research say about whether they should be wholly separate, or with managers and related directors out of room for specific topics?

10. the meaning of "monitors compliance" is unclear: are there any best practice, legally required, or specific public well being circumstances when Board members are required to go public with their ethical or governance concerns?

The call for comments adds the requirement that these proposals be assessed in terms of their impact upon investment trusts. These new entities are controversial, in that they shield business enterprises from corporate taxes. There are reasons to question whether they will survive in their current form. In principle, these rules should apply to any limited liability entity. In reality, these artificial, legally-defined, organizations are less responsive and accountable than traditional corporations.

Reference: David Olive, "Institutional Investors and Corporate Governance," in *The Corporate Ethics Monitor* (March-April 1992) vol 4, issue 2

Reference: Bill Dimma, "Ethical Behaviour Matters," in The Corporate Ethics Monitor, (July-August 2003) vol 15, issue 4

Reference: David Nitkin, “Good governance for sustainable corporations,” in The Corporate Ethics Monitor, May-June 2003) vol 15, issue 3.

Reference: Gay Miller and Eric Litwack, “Governance Scorecard,” in The Corporate Ethics Monitor, (November-December 2003) vol 15, issue 6.

Reference: David Olive, “Corporate Governance in Europe,” in *The Corporate Ethics Monitor,* (September-October 2003) vol 15, issue 5.

A review of these articles, observations, references and research reports leads to the following recommendations:

Recommendation Twelve: The regulator should require that a corporate annual report be conducted by an independent auditor, reporting directly to an audit committee of the Board, and contain a multi-stakeholder risk-based corporate responsibility report verified by an independent auditor.

Recommendation Thirteen: The regulator should require that larger incorporated companies above a certain size be required to conduct and publicly release a regular, independent and externally verified, Social or Ethics Audit of its operations.

Recommendation Fourteen: The regulator shall adopt the principle of trying to harmonize Canadian integrity-based principles with U.S.-style compliance initiatives and European-based guidelines

6. Democracy and Accountability Research and Recommendations

It will take time for a majority of directors, politicians and regulators to get the message that companies can and should do well by integrating stakeholder concerns into their decisions. Shareholders don’t need further protection from stakeholders. They need protection from short-sighted directors, weakly-articulated regulatory principles, overly-compliant accountants and auditors, and ineffective laws that turn management focus toward quarterly financial performance returns and away from issues that are in the long term interest of all a corporation’s stakeholders.

For reasons that are inexplicable, the language of accountability, reputation and transparency don’t find much place or space in these proposals. Despite high profile, widespread public concern about confidence in public markets, the need for shareholder empowerment, and initiatives to address a democratic deficit in society, these public policy issues and concerns find little resonance in the proposed policy and reporting instrument.

Greater transparency would make directors properly responsive to stakeholder interests and would bolster the hand of directors, officers and others who believe that democracy, transparency, accountability are worthy of consideration and action where appropriate. Likewise, greater transparency in accounting, auditing and reporting would increase public confidence and trust in regulatory frameworks, professional associations, business consultants, and a free marketplace.

In law, corporations are entities that, unlike individuals, have a favoured status of limited liabilities. Companies and organizations have mandated responsibility generally limited to filing returns, competing fairly, and not breaking the law. However, legal compliance is not the same as democratic or responsible practice. Officers and directors who act on behalf of the firm in ways that violate the "commonweal" are increasingly finding that regulators, the courts, investors and the public expect them to accept personal responsibility and liability in law for serious health, safety, environmental and other transgressions or violations. This is inducing an unwelcome chill in some individuals or groups in terms of personal unwillingness to serve as a corporate director.

Typically, Directors learn about vulnerabilities from executives, investigative journalists, or conscience-driven employees. In almost all cases of serious corporate wrong-doing, EthicScan has found that people in the organization—at the level below the top executive team—suspected or knew that something was wrong. These employees believed that someone was covering up, that deliberate malfeasance was possible, or (in the best case) that management was taking an unrealistic look through rosy glasses.

Sunlight, or transparency, is a great disinfectant to corruption and illegality. Regulars in other jurisdictions look to incentives and protection for employee whistle-blowers with large organizations, including allowing them to participate actively in litigation and fine-sharing even after the courts or government are involved. Regrettably in Canada, whistle-blowers run the real risk of loss of income, job, career, health and assets. These Guidelines ignore the preventative element against wrongdoing implicit in such programs, and miss an opportunity for regulatory leadership.

A related concern is the transparency of companies, particularly as it relates to controlling shareholders or corporate financing of campaign contributions. Business donations to elected officials have always tainted or strained Canada's political process, from the Macdonald railway scandal to the present. Improper solicitation, collection and use of election funds are seen as the Achilles heel of politicians and lobbyists in public life. At least in private, many politicians will admit that a dependence on corporate handouts can pervert the political system. People may want government to be more effective but they do not want government to be dominated by corporate power.

Rewarding political campaign supporters with favouritism in jobs or contracts is seen as inappropriate. Tax breaks linked political contributions by corporations are seen as inequitable. Why is the issuer of corporate political contributions, or at least their reporting, not addressed in these regulations? Not all members of EthicScan's Board agree with recommendation seventeen in this regard.

An honest profit should rest comfortably on the pocketbook and conscience. Most publics or constituencies would see it as fair to make responsibility for self-reporting of responsibility-violating performance a particular onus of a corporate wrong-doer. Why isn't it required for companies that are found guilty, for example, of abusing human rights or violating fair competition laws to report this in their annual reports? The precedent for treating wrongdoers differently—and requiring candor-- was set in the 1980's by states like California which required companies to report non-compliance with the anti-apartheid Sullivan Principles.

The question here is whether regulators, acting in concert with industry associations, could mandate or encourage public reporting in corporate annual reports of non-compliance with existing national or international social responsibility standards. To address corporate reluctance to self incriminate, in the case of allegations rather than conviction of non-compliance, this requirement would include reporting non-compliance data above a certain standard but below an illegal level.

In summary, disclosure would be more meaningful if issuers were required to describe their practices in terms of either legal compliance (at a minimum) or ethics, governance, organizational due diligence, fiduciary responsibility, democratic practice, candor and accountability (as an integrity standard above legal compliance). Regrettably the proposed policy and instrument fall dramatically short of requiring companies to report on their governance principles or practices, using accepted frameworks such as the Global Reporting Initiative or the United Nations' Global Compact, either here in Canada or elsewhere.

Reference: Neil Smith, "Social Auditing's Next Phase," in *The Corporate Ethics Monitor* (January-February 2001) vol 13, issue 1;

Reference: David Nitkin, "Ethical audits and ethical assurance," in *The Corporate Ethics Monitor* (September-October 1996) vol 8, issue 5.

Reference: David Olive, "The Reform of Election Financing," in *The Corporate Ethics Monitor* (March-April 1990), vol 2, issue 2

Reference: David Nitkin, "Ethical Challenges for Corporate Secretaries and Chief Ethics Officers, in *The Corporate Ethics Monitor*, (July-August 1995) vol 7, issue 4

Reference: Ed Waitzer, "Anti-Apartheid Disclosure", in *The Corporate Ethics Monitor,* (January-February 1990) vol 2, issue 1.

Reference: David Nitkin, "Proactive Management of Environmental Impacts", in *The Corporate Ethics Monitor,* (March-April 1990) vol 2, issue 2

A review of these corporate accountability, democracy and disclosure articles, observations and research leads to the following recommendations:

Recommendation Fifteen: The regulator shall provide best practice advice about how and to whom Directors, management and staff can report illegal behaviour (ethics officer, ombudsperson, hotline, Management Committee, et cetera) and who investigates.

Recommendation Sixteen: The regulator should require employers to protect public and private sector employees who whistle-blow in the public interest

Recommendation Seventeen: The regulator shall require companies to report fully on all political campaign contributions.

Recommendation Eighteen: The regulator would require companies to report on non-compliance with health, safety, labour union, fair competition, environmental and other rules.

Recommendation Nineteen: The regulator would require companies to disclose and discuss local health, safety, security and environmental hazards and risks in annual, open community forums co-hosted by local community leaders.

Recommendation Twenty: The regulator shall sponsor research and conduct multi-stakeholder dialogue about the implications of accountability-related corporate practices or regulations such as lifetime bans on convicted corrupt directors and executives, independent community stakeholder-based assessment of local corporate performance, and full cost accounting.

7. Conclusion

Overall, EthicScan is pleased to note that ethics is receiving its due as a consideration of, and requirement for, good governance. As envisaged in the proposed policy and reporting instrument, companies are expected to report on ethics in much the way they would Board structures. Regrettably, there are three problems with this approach. One, there is no evidence that having a code warrantees profitable or ethical outcomes. This is consistent with research findings denying any link between governance structure, independent directors and Board structure, on the one hand, and financial returns, on the other. Two, an ethics code is not a prerequisite for ethical actions. An integrated set of ethics guidance, training and reinforcement tools, supported by ethical executives and managers, however, is. Three, companies and civil society organizations need regulators and professional bodies like yourselves to champion and mandate suitable ethical inoculation research, education and tools like ethics audits, accountability statements, and social, ethical and environmental risk analysis (S.E.E. Risk Analysis). Such proactive tools would help allow executives, directors and employees of conscience to report and act upon concerns or suspected wrongdoing.

It is no longer acceptable for companies to decide whether or not they will decline to disclose when they are found guilty of failing to respect pollution, fair competition, and labour laws. Disclosure would be more meaningful if issuers were required to describe their integrity-related practices in terms of widely-accepted governance norms including ethics, governance, organizational due diligence, fiduciary responsibility, democratic practice, candor and accountability. Regrettably, the proposed policy and instrument fall dramatically short of clarifying either what are best practices, either in Canada or elsewhere, or how they can be realised, reinforced and made to live in Canadian companies.

8. Summary of Recommendations:

Recommendation One: The regulator should require issuers to report upon their ethical management structure as well as use of specific, integrated and comprehensive, ethics and governance tools

Recommendation Two: The regulator should mandate that each issuer designate a chief ethics officer for the organization, and require professional training for that executive.

Recommendation Three: The regulator should provide meaningful education, support, recognition and resources in terms of best practice for organizational ethics guidance, training and reinforcement.

Recommendation Four: The regulator should provide meaningful guidance in terms of best practice ethics codes. Such practices could require that such business practice conduct codes are routinely updated, apply to all business units, explicitly address variations in international morality and laws depending upon jurisdiction, be the basis for ongoing employee training, and be translated into the language of local usage. Where these best practices aren’t followed, reasons shall be required.

Recommendation Five: The regulator should provide useful guidance in terms of a recommended set of independent mechanisms that support assurance, accountability and transparency

Recommendation Six: Until and when a national securities system is in place, provincial and territorial securities bodies should sponsor ongoing multi-stakeholder research and dialogue on means to enhance faith on the part of investors, insurers, employees, financial planners and others in our capital markets

Recommendation Seven: Until and when a national securities system is in place, provincial and territorial securities bodies should commit themselves to implement policies and principles that link accounting and auditing standards, legal compliance, forensic standards, and anti-corruption initiatives with corporate responsibility and accountability

Recommendation Eight: The regulator should support requirements that the company demonstrate in detail that in its Board composition and decision-making it addresses the needs and voice of all stakeholders, including non-shareholder constituencies

Recommendation Nine: The regulator should recognize the right and responsibility of Board directors to monitor ethical decisions by executives, taking the liability and decision to violate the ethics code out of the hands of individual employees, and demonstrating that no-one over-rules the Board.

Recommendation Ten: No individual employee should have the right to waive an ethics code requirement, although the executive committee and Board may do so, but only if they explain the reasons for that decision.

Recommendation Eleven: The regulator should provide meaningful guidance in terms of best governance practice, for the use of Directors, lawyers, insurers, accountants, auditors, and others. Such practices could include seeking outside advice, regular assessment of individual and group performance, individual nomination of directors, and limits on consecutive appointments. . Where these best practices aren't followed, reasons shall be required.

Recommendation Twelve: The regulator should require that a corporate annual report be conducted by an independent auditor, reporting directly to an audit committee of the Board, and contain a multi-stakeholder risk-based corporate responsibility report verified by an independent auditor.

Recommendation Thirteen: The regulator should require that larger incorporated companies above a certain size be required to conduct and publicly release a regular, independent and externally verified Social or Ethics Audit of its operations.

Recommendation Fourteen: The regulator shall try to harmonize Canadian integrity-based principles with U.S.-style compliance initiatives and European-based guidelines

Recommendation Fifteen: The regulator shall provide best practice advice about how and to whom Directors, management and staff can report illegal behaviour (ethics officer, ombudsperson, hotline, Management Committee, et cetera) and who investigates.

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9. Caution with Respect to Conflict of Interest

EthicScan Canada derives income from researching corporate responsibility and offering ethics consulting services. The Commissioners should be aware that certain suggestions herein could result in an increase in demand for the research, education or consulting business of EthicScan. Notable examples could include recommendations involving chief ethics officers, social audits and SEE Risk Analysis.