

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

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8
Fax: (416) 593-2318
Email: jstevenson@osc.gov.on.ca

Re: Request for Comment – Notice of Proposed Multilateral Policy 58-201, Effective Corporate Governance and Proposed Multilateral Instrument 58-101, Disclosure of Corporate Governance Practices

Dear Sirs and Mesdames:

The Ethical Funds Company™ is pleased to respond to the request for comments on the Canadian Securities Administrators' Proposed Multilateral Policy 58-201, Effective Corporate Governance and Proposed Multilateral Instrument 58-101, Disclosure of Corporate Governance Practices.

About The Ethical Funds Company

Owned by Canada's credit union system, **The Ethical Funds Company** is part of the co-operative movement's mission to foster community well-being while providing a full complement of quality financial products and services. **The Ethical Funds Company** is Canada's leading manager of socially responsible mutual funds with approximately \$1.8 billion in assets under management, invested on behalf of 170,000 unitholders. We achieve solid financial returns by applying leading-edge investment disciplines and investing in companies that work continuously to improve their social and environmental performance.



We define socially responsible investing (SRI) as an investment strategy designed to realize financial, social, and environmental gain. In addition to evaluating all investments according to their financial, social, and environmental performance and outlook, **The Ethical Funds Company** works with the companies, regulators, and like-minded organizations to encourage corporate accountability, sustainability and market integrity.

Statement of Support

The Ethical Funds Company believes that good corporate governance is an essential element for delivering long term corporate financial, social, and environmental performance. We also believe that in a competitive global economy, Canadian standards must equal best international practice. If we fail to meet this standard, we risk eroding investor confidence in Canadian companies, Canadian capital markets, and the Canadian economy. To this end, we support the efforts of the Canadian Securities Administrators to enhance good governance and market integrity through the proposed Multilateral Policy and Instrument.

‘Comply or Explain’ Approach

We support the ‘comply with best practices or explain’ approach advocated by the CSA. We observe, however, that in relying upon disclosure as an enforcement mechanism, the regulatory environment in Canada must ensure that investment managers devote more energy towards monitoring corporate governance performance. In the absence of watchful investment institutions, companies may be tempted to refrain from a vigilant implementation of best practices.

To this end, **The Ethical Funds Company** believes it is imperative that security regulators in Canada require pension funds and mutual funds to disclose proxy voting policies and actual proxy voting activity. We note that the CSA has already recognized the importance of proxy voting in its Request for Comment stating “...a number of Canadian institutional investors and other organizations have significantly influenced governance practices through proxy voting guidelines that focus on governance matters and by influencing the establishment of best practices.” The United States Securities Exchange Commission has also recognized the importance of proxy voting by passing a new rule in January 2003 that requires mutual funds to disclose proxy voting policies and activity. The new rule comes into force June 30, 2004. The SEC rule is premised on the belief that poor governance practices contributed to a series of accounting failures and subsequently had a negative impact on public confidence in capital markets.

The Ethical Funds Company believes that proxy voting disclosure across the industry would help ensure that pension funds and mutual funds are supporting corporate governance practices that are consistent with the best interests of investors, stock markets, and the public. It is less likely that many of the inadequate corporate governance practices now coming to light would have been tolerated had these been more widely known and recognized as detrimental to the long term health of the corporation. Mandatory proxy

voting disclosure is a crucial step toward ensuring that mutual funds and pension funds become part of a process of encouraging improved corporate governance practices. Absent pressure from institutional members, regulators on their own will be hard-pressed to ensure that companies are living up to the corporate governance principles they espouse.

With these remarks as preface, we now turn to 58-201 and 58-101. In general, we support the recommendations proposed. We focus our remarks on areas where we believe there is room for improvement.

Defining Independence

Directors of publicly-traded companies cannot perform their role credibly if they depend on the corporation for any benefit or consideration. The CSA should offer more specific guidance concerning the various forms of related or material relationships that can exist between a director and a company. The Council of Institutional Investors offers an extensive description of the types of business, employment, and familial relationships which could interfere with the exercise of a director's independent judgment. The CSA should require companies to disclose if they have referenced the CII's descriptions and declare reasons for being satisfied that such relationships do not exist or are not material. Further, the CSA should require that companies individually identify which directors are considered independent under the CII definition of independence in order to avoid any use of boilerplate declarations such as "the board is constituted of a majority of independent directors."

The Ethical Funds Company believes that a majority of directors should be independent and that the nominations, audit, and compensation committees should be composed entirely of independent directors.

Code of Business Conduct and Ethics

The Ethical Funds Company supports the adoption of written codes of conduct and ethics, but recommends that the subject matter specified expand to include social and environmental policies and risk management systems adopted by the board.

Corporate social responsibility policies as significant components of a written code of conduct are increasingly becoming the norm among large well-managed companies. Such policies allow companies to be alert to and manage the risks associated with social and environmental impacts and to take strategic advantage of new opportunities in providing products with social and environmental benefits. Corporate social responsibility policies can also help to attract and retain top employees and, for certain industries, secure community consent when locating facilities and developing projects.

The financial and economic value of corporate social responsibility is being recognized by an increasing number of regulatory agencies and stock markets around the world. In South Africa, for example, the

widely-respected *King II Report on Corporate Governance* explicitly recognizes that environment, health, and safety issues impose specific duties on directors. To discharge these duties, companies wishing to list on the Johannesburg Stock Exchange are now required to report on their social and environmental performance in accordance with the Global Reporting Initiative, a United Nations-sponsored reporting format. In France, the *Loi sur les Nouvelles Régulations Economiques* requires corporations to publish social and environmental information in their annual reports. In the United Kingdom, the government has recently published proposals for the *Operating and Financial Review (OFR)*. The OFR will include information on the employees of the company; environmental matters; and social and community issues, where the directors judge this necessary to enable shareholders “to assess the strategies adopted by the company and the potential for those strategies to succeed.”

In the 21st Century best corporate governance practice recognizes the risks and strategic opportunities that social and environmental issues can bring to a company. For this reason, we believe that boards of directors must begin to build the capacity to make informed judgments in these areas. The CSA should consider requiring companies to disclose their orientation toward corporate social responsibility and how they manage these social and environmental issues in their code of business conduct and ethics.

Disclosure of Code of Business Conduct and Ethics

The Proposed Disclosure of Corporate Governance Practices calls upon companies to file the code on SEDAR. **The Ethical Funds Company** supports this level of disclosure but recommends that companies also be required to disclose their code on their web site.

The Ethical Funds Company strongly supports the requirement that companies must issue a media release whenever the board of directors grants a waiver of the code in favour of an officer or director. Infamously, Enron waived their own ethics code on more than one occasion to allow the company’s Chief Financial Officer to serve as general partner for the partnerships it was using as a conduit for much of its business. The waivers were not disclosed, thus depriving shareholders and the market of opportunities to remedy ethical and corporate government deficiencies.

Compensation Committee

Executive compensation serves as one of the most significant challenges for re-establishing investor confidence in capital markets and publicly-traded corporations. Executive compensation is the litmus test for good governance: no one can believe that a board is doing its job if executive pay exceeds industry norms while share price and other measures of performance are trending downward.

To ensure appropriate shareholder and board oversight of executive compensation, **The Ethical Funds Company** supports the view that compensation committees should have written charters. We also support the view that companies should disclose the process used to determine compensation. Further, we believe

that companies should disclose the parameters that determine executive pay. In our view, compensation plans should be tied to objective parameters of company performance such as earnings, return on capital, returns to shareholders, and other relevant measures. If stock prices are used as a parameter, they should be compared to the value of stock in the company's relevant peer group as a whole rather than to absolute gains or declines in value. In addition, we believe that executive compensation should be tied to environmental performance, widely-accepted measures of occupational health and safety and evidence of progressive community relations, ethical business practices, and respect for international human rights.

Nominations Committee

Boards should have a nominating committee to identify, recruit, nominate, and orient new directors. The nominating committee's charter should be clearly described and disclosed. Companies should also be required to disclose nominating committee procedures including: whether the company pays a third party to assist in the nominating process; the minimum qualifications the company seeks for director nominees; whether the company considers director candidates put forth by shareholders and, if so, its procedures for such consideration; a statement as to which persons in the following categories recommended each nominee: shareholder, non-management director, chief executive officer, other executive officer, third-party search firm or other specified sources.

The Ethical Funds Company also believes that companies need to take deliberate steps to look beyond traditional director candidates. We believe that each pool of nominees brought forward for consideration by the nominating committee should reflect the diversity of the workforce and society, thereby ensuring that a variety of views are heard and factored into decision-making. Women and minority nominees should be sought and due consideration given to their election to the board unless doing so violates the CII definition of independence.

Regular Assessment of Board Performance

Boards of directors must evaluate their own performance, as a board, as committees, and as individual directors. This presents potential conflicts of interest. For this reason, **The Ethical Funds Company** believes that companies should perform board, committee, and individual director performance evaluations on an annual basis. A summary of each individual evaluation should be included with disclosure of directors' compensation in the annual proxy circular.

General Disclosure

58-101 calls for disclosure of these data in the Annual Information Form. This is inappropriate. While sophisticated and dogged investors can access the AIF through SEDAR, **The Ethical Funds Company** believes that most investors focus on information provided in the Management Information Circular

mailed to all investors in advance of annual general meetings. The information circular should be the primary vehicle for corporate governance disclosure.

Further, SRI analysts at **The Ethical Funds Company** have expressed support for the tabular format in which corporate governance information is now disclosed by many Canadian companies. This format is accessible and facilitates useful comparisons with competitors. **The Ethical Funds Company** recommends that the CSA require companies to use this format in making their disclosures under 58-101.

Closing Remarks

We appreciate the opportunity to comment on the CSA's proposed Multilateral Policy for Effective Corporate Governance. As stated above, we support the principles, standards, and guidelines promulgated by the CSA. However, we believe that the revisions recommended in this letter would do much to raise standards to a level necessary for Canadian companies and Canadian markets to compete in a global economy. We believe that in order for best practices to become fact and for a strong corporate governance culture to be established in this country, institutional investors must become more active in monitoring and encouraging best governance practices. We believe that regulators can encourage this level of activity by requiring mutual funds and pension funds to disclose their proxy voting guidelines and voting record. This disclosure will reduce the rubberstamping of management recommended votes and ensure that institutional investors are voting in favour of best governance practice, ethics, and market integrity.

If you have any questions or seek elaboration of our views, please do not hesitate to contact us.

With Best Regards,

THE ETHICAL FUNDS COMPANY



Robert Walker
Vice President, SRI Policy & Research
Telephone: (604) 714-3833
Email: rwalker@credential.com