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July 27, 2004

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorite des marches financiers
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
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Suite 1900, Box 55
Toronto, Ontario M5H 3S8
Fax: (416) 593-2318
Email: jstevenson@osc.gov.on.ca

Re: National Instrument 81-106 and mutual fund proxy voting disclosure

Dear Sirs and Mesdames:

The Ethical Funds Company™ is responding to proposed changes to mutual fund proxy voting disclosure requirements as described in National Instrument 81-106.

About The Ethical Funds Company

Launched in 1992, **The Ethical Funds Company** is Canada's leading manager of socially responsible mutual funds. In addition to evaluating all investments according to their financial, social, and environmental performance and outlook, **The Ethical Funds Company** works with companies, regulators, and like-minded organizations to encourage corporate accountability, sustainability and market integrity.

The Ethical Funds Company began disclosing proxy voting policies in 2000 and proxy voting activity in 2001 – the first mutual fund company in Canada to do so. Our proxy voting is disclosed on our Web site at www.ethicalfunds.com/do_the_right_thing/sri/shareholder_action/proxy_voting.asp

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Ethical Funds Inc.



Statement of Support

Historically, mutual funds have not disclosed proxy voting guidelines or proxy votes and have been viewed as passive investors reluctant to challenge corporate management on such issues as corporate governance or executive compensation. Funds have typically followed the so-called “Wall Street walk” according to which an investor should either vote as management recommends or, if dissatisfied with management, sell the stock.

Some observers have criticized this practice noting both the potential influence of mutual funds on corporate performance and the potential conflict of interest that arises when a fund manager seeks to manage the retirement plan assets of a company whose securities are also held by the fund. In these situations a fund may have an incentive to support management recommendations to further its business interests rather than the interests of the mutual fund unitholder.

Further, recent corporate governance scandals have underscored the need for mutual funds and other institutional investors to play a more active role in corporate governance. The wide-ranging nature of these scandals and the negative impact on overall investor confidence demonstrate the folly of the Wall Street walk and indicate a need for institutional investors to embrace a higher standard of duty and care as stockholders and as fiduciaries. **The Ethical Funds Company** believes that as major players in our financial and corporate systems, mutual funds have an obligation to advance integrity and legitimacy. If for no reason, we must do so because our ability to meet our financial obligations depends upon the health of these interrelated systems.

In recognition of these facts, the United States Securities and Exchange Commission (SEC) has recently adopted a new rule requiring mutual funds to disclose the policies and procedures they use to vote proxies and to file with the SEC and make available to shareholders the specific proxy votes they cast. The SEC rule is premised on the belief that poor governance practices contributed to a series of accounting failures which subsequently had a negative impact on public confidence in capital markets.

We are pleased to see that the Canadian Securities Administrators (CSA) has promulgated a disclosure requirement similar to that now in use in the United States.

We believe that disclosure will:

- mitigate the potential conflict of interest described above;
- subject mutual funds to increased scrutiny by unitholders and pressure them to refrain from merely rubber-stamping management decisions;
- prompt mutual funds to play a more active role in promoting sound corporate governance and improved corporate accountability;
- foster improved corporate governance and greater corporate social responsibility by making corporate managers and directors more responsive to the concerns of mutual funds and other institutional investors; and

- help build a broader base of well informed investors by introducing mutual fund unitholders to the importance of proxy voting.

Materiality of Proxy Voting and Investor Education

One commenter has offered the view that information provided in the proxy voting record is not material to the buy, hold, and sell decisions of the average Canadian investor.

In response, **The Ethical Funds Company** acknowledges that most Canadian investors buy mutual fund units oblivious to the opportunity for mutual funds to vote proxies on their behalf. We also argue that most Canadian mutual fund investors are, unfortunately, oblivious to the securities contained in the funds they buy. Investor market research conducted by ADP Investor Communications in May 2002 indicates that many (if not most) investors do not understand the relevance of the disclosure documents they receive and that only 6% of the respondents are familiar with the existence or intended purpose of the prospectus as a basic disclosure document.

This lack of awareness is disturbing. It does not serve the interests of investors, capital markets or our economy. **The Ethical Funds Company** believes that our industry has a duty to educate investors about securities markets, the investment industry and our responsibilities as security-holders. A basic understanding of the importance of proxy voting and the manner in which proxies are voted should be part of this education.

Materiality of Proxy Voting and Fiduciary Duty

Mutual funds hold publicly-traded securities in trust for the benefit of unitholders. Thus, they have a fiduciary duty to unitholders and a positive obligation to disclose all pertinent information regarding the management of the funds. **The Ethical Funds Company** believes proxy voting falls into this category. The Association for Investment Management and Research (AIMR) asserts in its *Standards of Practice Handbook* that "Not exercising these [proxy voting] 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."

We can think of no other instance whereby securities regulators countenance opacity rather than transparency in the discharge of fiduciary duty.

Costs Associated with Proxy Voting and Disclosure

We expect that some organizations may express the view that proxy voting disclosure places a costly burden on the mutual fund company – a cost which will then be passed to the unitholder.

The experience of **The Ethical Funds Company** with management expense ratios (MER) and proxy voting disclosure provides an empirical record that contravenes this view. Historically, our MERs are

below industry average for the majority of our funds. For the period ending June 30, 2004, 8 of our 10 mutual fund MERs were below industry average. Cost is not a barrier to proxy voting disclosure.

Disclosure Format

Section 10 of the proposed National Instrument specifies that mutual funds should establish proxy voting policies and procedures, compile proxy voting records, and disclose proxy voting activity.

The Ethical Funds Company believes that the requirements specified by the CSA are cumbersome and that our methodology provides a superior level of disclosure to unitholders at a lower cost to mutual fund companies.

We disclose our proxy voting policies each year in a document published on our Web site, in advance of proxy voting season. The annual publication of this document is accompanied by a media release. We inform unitholders about our proxy voting practices in our prospectus as well as our annual and semi-annual reports. We also disclose our actual proxy voting activity on our Web site. In general, throughout proxy voting season, we are able to provide our voting intentions several days before each company's annual general meeting. Visitors to our Web site are able to sort our proxy voting record by company name or by company annual general meeting date.

In our experience, this level of disclosure satisfies our unitholders' needs in a cost effective manner. **The Ethical Funds Company** recommends that the CSA amend the rule to allow mutual fund companies to comply with disclosure requirements using this method.

Securities Lending

Many mutual fund companies engage in securities lending. Under securities lending programs, mutual funds lend securities to third party borrowers. The borrower promises to return to the mutual fund company at a later date an equal number of the same securities and to pay a fee for the borrowing the securities. The transaction permits mutual fund companies to retain exposure to changes in the value of the borrowed securities while earning additional fees which are repatriated to the unitholders.

While mutual fund lenders continue to share in the company's fortune, as measured by the rise or fall of its stock price, they forfeit the right to vote proxies. For securities out on loan, the borrower has the voting rights. Voting rights revert to the lender when the transaction is complete.

This is a perverse situation given that the borrower ostensibly has no interest in these voting rights. That interest – and therefore that responsibility – is retained by responsible mutual fund companies.

The Ethical Funds Company strongly recommends that securities regulators make the necessary changes to ensure that mutual funds engaging in securities lending retain the right to vote proxies.

Voting Securities ex Canada and ex USA

In many countries, proxy voting can be complicated and onerous. In some countries, for example, proxy materials are not generally available until 15 days prior to an annual general meeting. Shareholders are thus unable to review proxy issues and company materials thoroughly. In many countries, there is no procedure for mailing in proxy votes and/or shareholders must attend meetings in person in order to exercise their vote. In some countries, proxy voters must attain power of attorney to vote. In others, omnibus account structures are common whereby custodians aggregate shares held on behalf of various clients in an omnibus account maintained by a sub-custodian. In some instances, if proxy votes are not uniform across all clients, there is a possibility that none of them will be counted, or one instruction will override others and all shares will end up being voted the same way, regardless of how the individual ballots were submitted.

In recognition of the challenges of voting proxies overseas, **The Ethical Funds Company** recommends that the CSA provide a "safe harbour" due diligence defense for the voting of proxies in countries where such barriers exist.

In Closing

The Ethical Funds Company believes that proxy voting disclosure is a fiduciary obligation owed by mutual funds to their unitholders. More broadly, proxy voting disclosure across the industry would help ensure that 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 and restoring investor confidence in our corporations and capital markets.

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



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