The Ethical Funds Company®

Recommendations for GRI Reporting and Disclosure

Submitted by

The Ethical Funds Company

Submitted to

The National Roundtables on Corporate Social Responsibility

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Introduction

This document represents the second formal submission by **The Ethical Funds Company** to the National Roundtables on Corporate Social Responsibility (CSR) and the Extractives Sectors.

As a member of the Roundtable Advisory Group, we have attended all 4 sessions held across the country and fully support the Canadian government's long term goal: to create a critical mass of Canadian extractives companies, operating in developing countries, which meet or exceed leading international corporate social responsibility standards and best practices.

To help advance this long term goal, our first roundtable submission considered existing corporate social responsibility standards and recommended the federal government use the Principles and Criteria of the Mining Certification Evaluation Project as a framework to develop a corporate social responsibility standard for Canadian extractive companies. The MCEP meets the necessary tests established by the Roundtable Steering Committee including multi-stakeholder support, technical soundness, and feasibility.[1]

By way of background, the federal government initiated these roundtables in response to a 2005 report from the Standing Committee on Foreign Affairs and International Trade (SCFAIT). The SCFAIT report recommended that the Government of Canada convene relevant stakeholders to address the corporate social responsibility of all Canadian extractives companies operating overseas. These recommendations stem from a growing number of reports made to SCFAIT alleging Canadian extractives companies are violating international human rights and failing to uphold applicable national environmental laws.

Throughout the four roundtables, the Roundtable Steering Committee has been compiling actionable ideas arising out of each meeting. An actionable idea demonstrates a technically-sound solution or approach to address a recognized CSR problem, is technically achievable within a reasonable timeframe and with a reasonable investment of resources, and should be acceptable to a broad range of stakeholders and policy actors. Following the last roundtable in Montreal, a final list of actionable ideas, established by consensus of the Steering Committee and Advisory Group, will be included in a report to the federal government as recommendations on how to address the corporate social responsibility of Canadian extractives companies operating overseas.

The purpose of our second submission is to recommend the federal government support enhanced corporate environmental, social, and governance disclosure.

Before proceeding we would like to acknowledge other significant actionable ideas that deserve support. A number of these fall into the category of legal mechanisms and thus are not within our area of expertise. Nevertheless, we highlight suggestions made to establish an ombudsperson for the extractives sector as well as legal remedies to deter corporate complicity in crimes against humanity, genocide, and war crimes. We have long recognized the absence of effective legal remedies and

[1] A copy of this submission is available on the CSR Roundtable website at http://geo.international.gc.ca/cip-pic/current_discussions/csr-roundtables-en.asp

sanctions for those corporations with poor environmental and social practices. An ombudsperson as well as civil and criminal statutes could offer greater accountability for overseas communities that have been negatively impacted by extractives projects. We offer our full support to other members of the roundtable Advisory Group who, acting in their expert roles, can best offer arguments in support of these ideas.

Another actionable idea we would like to highlight here recommends the federal government amend the Canadian Environmental Protection Act (CEPA 1999) to extend National Pollutant Release Inventory (NPRI) reporting requirements to the overseas operations of Canadian companies. This actionable idea was put forward leading up to the deadline for roundtable submissions. As such we will support this recommendation as arguments for its technical soundness, multi-stakeholder support, and feasibility evolve.

For our part, we can offer informed arguments to address the capital markets and options to enhance corporate environmental, social, and governance (ESG) disclosure.

As an active shareholder, The Ethical Funds Company has found that pressing companies for enhanced ESG disclosure has a wider effect on improving their business practices. As companies begin to gather the data to measure their environmental and social impacts, they are forced to take a closer look at how these issues are affecting their business. Simply put, what gets measured gets managed.

In our second roundtable submission we focus on ways to enhance corporate environmental, social, and governance disclosure through implementation of the following four actionable ideas:

1. Funding from the federal government to support development of sector-specific reporting guidelines for junior mining exploration, oil & gas exploration, oil & gas exploration and production, and integrated oil & gas companies.
2. Graduated reporting requirements for TSX-listed companies to disclose material ESG issues using the Global Reporting Initiative's reporting framework
3. Reform the Canada Business Corporations Act (CBCA) to require reporting on material environmental, social, and governance issues
4. Regulatory reform of the Pension Benefits Standards Act to require pension plans to disclose policies addressing evaluation of material ESG issues.

Recommendation 1: Funding from the federal government to support development of sector-specific reporting guidelines for junior mining exploration, oil & gas exploration, oil & gas exploration and production, and integrated oil & gas companies.

We recommend that our federal government support enhanced ESG disclosure by providing funding for the development of sector specific reporting guidelines for mining exploration, oil & gas exploration, oil & gas exploration and production, and integrated oil & gas. These specific activities within the mining and oil & gas sectors reflect existing business models. We must provide companies with guidelines and reporting indicators that are relevant to their business and relevant to investors and other report readers. We suggest that these sector-specific reporting guidelines be developed through a multi-stakeholder forum of the Global Reporting Initiative

(GRI). As will be discussed later, the GRI is becoming the global gold standard for corporate reporting on environmental and social issues.

It is vital that that these sector-supplements are created to assist extractive companies in reporting on their environmental impacts and to provide data that is relevant to investors and other interested stakeholders. Early users of the GRI Sustainability Guidelines found that many of the reporting indicators were not relevant to their business activities. For this reason the GRI has produced a number of successful sector supplements, including Mining & Metals sector supplement applicable for senior mine producers with operating mines.

Roundtable participants agree that the junior mining sector faces the greatest resource challenge both in establishing effective corporate social responsibility practices, and also in reporting on these initiatives. Federal funding to support guidelines for this and other extractives sectors would greatly enhance ESG disclosure.

Once these tools are available, there must also be measures to support their use. As such we make our next two recommendations.

Recommendation 2: Graduated reporting requirements for TSX-listed companies to disclose material ESG issues using the Global Reporting Initiative's reporting framework

We support the recommendation that the TSX enhance its listing requirements to include a graduated requirement to disclose material ESG information using the GRI Sustainability Guidelines. Currently the TSX Venture Exchange and TSX Stock Exchange offer graduated listing requirements for oil & gas and mining companies based on a number of criteria including; assets, type and level of activity, and market capitalization. We propose a similar graduated ESG disclosure requirement. Most junior mining companies only conduct exploration and have a relatively limited environmental and social impact. Most senior producers typically operate one or more mines and have a much more substantial environmental and social footprint. Improved disclosure will increase investor confidence in the capital markets, allow investors to protect against ESG risks, and by extension, reward companies with more sustainable business practices.

Background: Why the Global Reporting Initiative?

Reporting on environmental, social, and governance performance has grown over the last decade with the Global Reporting Initiative Sustainability Guidelines representing the most comprehensive and universal set of reporting indicators available. Established in 2002 as an independent organization, the GRI is a multi-stakeholder initiative aimed at establishing a comparable set of reporting indicators on corporate environmental, and social, and governance performance similar to existing standardized financial reporting. Based in Amsterdam, the GRI has just released their third version of the Sustainability Guidelines, commonly referred to as G3. This version of the Guidelines was developed through consultation with hundreds of stakeholders globally, including business, investors, and non-governmental organizations. Currently almost 900 organizations, the majority of which are corporations, are registered users of the GRI reporting framework.

In 2005 the International Council on Mining and Metals (ICMM) endorsed the GRI and its members committed to producing sustainability reports using the GRI no later than 2007. Further, ICMM participated in the development of the Mining and Metals Sector Supplement which includes indicators which address economic, social, and environmental challenges unique to the mining sector.

Further the GRI has recently partnered with the Global Compact (GC) to create a reporting tool to aid GC signatories in producing their annual Report on Progress. The Global Compact is an initiative of the United Nations which obliges corporations to support 11 principles addressing the environment, human rights, and corruption. Global Compact signatories must produce an annual Report on Progress explaining how they are fulfilling the GC Principles. The GC Principles are particularly relevant to extractive companies given this sector's heavy environmental footprint and impacts on communities. This partnership demonstrates the prominence of the Global Reporting Initiative as an effective reporting framework that provides comparable reporting metrics that both eases the reporting burden for companies and provides investors and other stakeholders with more comparable data.

As well, numerous agencies have referenced the GRI Sustainability Guidelines in drafting various standards including the US Environmental Protection Agency, the European Union Framework for Corporate Social Responsibility, France's Nouvelle Regulation Economique (NRE), and various voluntary guidelines in Australia, Japan, and the UK.[2] With the release of the G3 in October 2006, the GRI Sustainability Guidelines are rapidly becoming the internationally accepted gold standard for corporate reporting on environmental, social, and governance performance.

Challenges

Concern was raised during the roundtables that GRI reporting may be an unwieldy burden for smaller companies. It is widely acknowledged that reporting on ESG performance is challenging, particularly for first time reporters. During the stakeholder consultation on the revised Sustainability Guidelines, the GRI was cognizant of this frequent criticism and the resulting G3 Guidelines have attempted to address this through a phased approach to GRI reporting.[3]

There are also a number of tools available to assist companies in using the GRI reporting framework. For example, the GRI has produced *High 5! Communicating your Business Success through Sustainability Reporting,* a how-to guide for small and medium sized enterprises to use the GRI reporting framework. As well, our federal government commissioned Stratos, a leading Canadian consultancy on sustainability reporting, to develop the *Sustainability Reporting Toolkit,* an on-line resource to assist companies in developing their first sustainability report.[4] Despite the challenges for first time reporters, the process of gathering data, analyzing, measuring, and reporting a company's impacts can create important internal awareness and drive improved performance going forward.

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[2] *Carrots and Sticks for Starters*, United Nations Environment Program and KPMG, 2005.
[3] For details on the GRI's phased reporting methodology please see the GRI Application Levels at http://www.globalreporting.org/Services/ReportServices/ApplicationLevelsCheck/ApplicationLevelsCriterion/ApplicationLevelsCriterionIMG.htm
[4] The Sustainability Reporting Toolkit is available at http://www.sustainabilityreporting.ca/home/default.asp?lang=e

Jurisdiction shopping

Some roundtable participants also cautioned that augmentation of TSX listing requirements may lead to jurisdiction shopping, particularly toward the UK AIM exchange, known for its more lenient listing requirements. AIM is the London Stock Exchange's international market for smaller companies. In its initial years the mining sector dominated this exchange.

Concern over jurisdiction shopping may be overstated. First, AIM itself presents some hurdles. Despite its reputation for having lenient listing requirements, initial listing fees are high and there are additional carrying costs involved as the company must retain a Nominated Advisor responsible for affirming the company complies with regulatory requirements. Further, the aftermarket for mining companies is not strong in the UK so share prices tend to fall after the initial offering. As well, there is a tax disadvantage in that foreign shareholders of Canadian companies listed on the AIM exchange must pay capital gains tax. In fact, at a recent road show hosted by AIM in Vancouver, BC, panel members suggested that for ex-UK companies, AIM is most attractive as a secondary exchange to list on in order to raise additional funds to grow their business. Further, one panel member suggested AIM is interested in diversifying its listings with particular interest in the technology sector –- not the extractive sectors.[5] It appears more likely that AIM seeks to compete with NASDAQ not the TSX Exchange or TSX Venture Exchange.

Second, other exchanges, including those for France, Denmark, Holland and South Africa have established guidelines for non-financial disclosure. The Johannesburg Exchange in South Africa has mandated GRI disclosure since 2003 with no evidence of negative consequences.[6]

Third, the capital markets in Canada remain attractive to the mining sector. The TSX offers graduated listing requirements to assist junior mining companies in attaining listed status. As well, Canada boasts a large community of analysts specializing in the junior mining sector unlike in London where mining analysts tend to focus on the senior mining companies. Most importantly, representatives from the TSX, in attendance at the roundtables, were supportive of ways to promote greater disclosure on corporate social responsibility.

Finally, the federal government could play a role in supporting enhanced listing requirements. The federal government should solicit interest from the TSX to jointly approach the International Organization of Securities Commissions to establish common listing requirements for the extractive sectors at stock exchanges globally. Common listing standards would help establish a level playing field and reduce the likelihood of jurisdiction shopping by companies motivated primarily by lenient listing requirements.

[5] Comment from panel member at AIM presentation held in Vancouver, BC on October 20, 2006
[6] Johannesburg Securities Exchange Requires Compliance with King II and Global Reporting Initiative, socialfunds.com, July 16, 2003

Recommendation 3: Reform the Canada Business Corporations Act (CBCA) to require reporting on material environmental, social, and governance issues using the GRI Sustainability Guidelines

The Ethical Funds Company supports the recommendation from the Social Investment Organization to amend the CBCA to require disclosure of material environmental, social, and governance performance using the GRI Sustainability Guidelines. Presumably this amendment would affect both public and private companies across all sectors incorporated under the CBCA. Aware that the CSR Roundtables are concerned specifically with the environmental, social, and governance practices of mining and oil & gas companies operating overseas, this wider reform will improve disclosure by all CBCA incorporated companies. Such disclosure will allow investors to better evaluate corporate environmental, social, and governance performance. In the case of private companies this amendment would rectify the current absence of disclosure and establish a degree of accountability for impacted communities and other concerned stakeholders.

It is hoped that such an amendment would also have the effect of sparking similar amendments among provincial jurisdictions. Investors, communities, first nations, civil society organizations, and other interested stakeholders are increasingly demanding that Canadian corporations disclose their environmental and social performance. Given that the CBCA will be open to review and revision this year, we recommend the federal government make this actionable idea a priority for consideration.

Background: The Canada Business Corporations Act

Canadian companies have the option to incorporate federally or provincially. The benefits to federal incorporation include wider protection of the corporate name across all provinces with the resulting benefit that such brand protection allows a federally incorporated company to conduct business in all provinces under the same name. Otherwise the regulations for incorporating federally and provincially are quite similar.

Challenges

Concern was raised during the roundtable that few mining companies are incorporated under the CBCA making such reform ineffectual. However our research indicates a reasonable percentage of federally incorporated companies in the extractives sectors. Among the mining sector, we found that 21 of the 45 mining companies listed on the TSX Composite Index are incorporated under the CBCA, or 47%. This 47% represents a combined market capitalization of approximately $84.9 billion.

On the TSX Venture Index, which includes most of Canada's junior mining companies, 46 of the 300 mining companies listed have incorporated under CBCA, or 15%. This 15% represents $5.0 billion in market capitalization.

For the oil & gas sector, only a small percentage of companies are incorporated under the CBCA with a majority instead incorporated in Alberta and British Columbia. This does not obviate the proposed CBCA reform, however, given that most of those oil & gas companies that do operate outside of Canada are incorporated under the CBCA. Thus CBCA legislative reform would capture those oil & gas companies that face risks arising from operating in states where the rule of law is weak and corruption is problematic.

There was also concern that mandatory reporting may not result in quality disclosure from companies, particularly smaller companies with limited resources. To address this we recall our recommendation for the federal government to provide funding to develop more detailed guidance documents to assist companies in preparing the necessary disclosures.

Since 2002 France has required mandatory ESG reporting for all corporations with the passage of its new economic law, or NRE (nouvelles régulations économiques). Specifically, companies must report on their environmental, labour, and community impacts. And in November 2006 the UK passed similar amendments to its Companies Act requiring companies to report anything concerning the welfare of its employees, the community, the environment and the company itself. Furthermore, The Companies Act 2006 establishes clear director responsibility to act in good faith on decisions regarding the company's impacts on the environment and community. [7]

Recommendation 4: Regulatory reform of the Pension Benefits Standards Act to require pension plans to disclose policies addressing evaluation of material ESG issues.

We support the recommendation that the federal government amend the Pension Benefits Standards Act to require federally-regulated pension funds and pension plans to annually disclose any responsible investment policies in place, and describe how these policies are implemented. A responsible investment policy may include engagement, proxy voting, and/or consideration of ESG analysis in investment decision-making.

Noting that the Pension Benefits Standards Act only applies to federally regulated pensions we further support the recommendation that the federal government, through the Office of the Superintendent of Financial Institutions (OSFI), encourage the adoption of a similar regulations by other members of the Canadian Association of Pension Supervisory Authorities.

This disclosure should be continuous, provided annually at a minimum. More specifically, disclosure should include whether the pension carries out direct engagement, outline any proxy voting guidelines and proxy voting results and the extent to which ESG considerations are incorporated into investment decision-making.

At first glance it may appear that pension fund disclosure will have little effect on the actual business practices of public corporations. However, similar to the argument for corporate ESG disclosure, what gets measured gets managed. Pension funds have historically been very cautious and typically emphasize profit maximization in their investment approach. This approach is often at odds with the values of the members for whom they are investing. The requirement to disclose any relevant responsible investing policies will require pensions to be more accountable to their members, who themselves may be very interested in seeing corporations adopt more

[7] The Companies Act 2006 is available on the website of the Office of Public Sector Information http://www.opsi.gov.uk/acts/acts2006a.htm

sustainable business practices. Pressure from members may promote pensions to take a more active shareholder role and in turn apply pressure on corporations in their portfolio of holdings, to reduce and mitigate the environmental and social impacts arising from their business operations.

Background

In considering this recommendation, the government of Canada would be joining a larger trend globally. Among the various approaches to active share ownership, governments around the world are recognizing the importance specifically of ESG considerations in investment decision-making.

In July 2000, the UK Pensions Act was amended to require trustees of occupational pension plans to disclose their policy on socially responsible investment as part of their Statement of Investment Principles (SIP). In recent years, France, Germany, Belgium and Sweden have adopted similar regulations and it is expected that most OECD countries will put similar reforms in place in the near future.[8]

A growing number of pension trustees and managers are recognizing the importance of ESG factors in their investment analysis. For example, the Enhanced Analytics Initiative, launched in October 2004, aims to create demand for ESG considerations in sell-side research. Signatories, currently representing USD 1.4 trillion in assets, agree to allocate five percent of their brokerage fees to the brokerage houses producing the best such research. We note both the CPPIB and Batirente are Canadian signatories. This initiative is proving successful, with the 5% of allocated commissions paid to brokerage firms in 2005 totaling approximately 8 million pounds sterling.[9]

Challenges

One major barrier for pension trustees in the past was the limited interpretation of fiduciary duty. Investors have long held that consideration of ESG may violate their fiduciary duty to achieve the highest possible returns for their clients. This position has been challenged in recent years with evidence that positive corporate environmental and social performance can impact long-term shareholder value. This debate advanced significantly in 2005 when Freshfields, Bruckhaus, Deringer, a leading UK law firm, conducted a review of the largest capital market jurisdictions, including Canada, and found that in all cases the law permits the integration of ESG issues. More significantly the study found that in certain cases failure to consider ESG issues may in fact constitute a breach of fiduciary duty.[10]

And there is further evidence that fiduciary duty includes consideration of ESG in investment analysis. A recent report from the United Nations Environmental Program Finance Initiative found that corporate ESG performance is material. Entitled, *Show Me the Money*, the report considered investment analysis from 22 financial

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[8] For details see the August 2005 submission from the Social Investment Organization to the Department of Finance available at
http://www.socialinvestment.ca/Policy&Advocacy/Pension%20Disclosure%200805%20Brief.pdf)
[9] www.**enhancedanalytics**.com
[10] *A legal framework for the integration of environmental, social and governance issues into institutional investment, Freshfields, Bruckhaus, Deringer, October 2005, available at http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf,*

institutions, including 10 sell-side brokerage houses, which found that ESG issues affect shareholder value in the short and long term. The reports noted similar issues of materiality such as the importance of public policy and regulation, brand and reputation as emerging categories of risk, the ability of companies to manage outsourcing and supply chain risk, and the overarching significance of corporate governance. Further, the report urged investors to "act on the links between ESG issues and company profitability".

A responsible investment policy also offers pensions a solution to their challenge as universal investors. Many pension plans manage a substantial amount of assets and as a result they effectively invest in the entire stock market in Canada. Such diversification helps reduce portfolio risk. However, when a company performs poorly, the fund manager has only two choices – sell or do nothing. A responsible investment policy can provide pensions with the opportunity to engage companies on issues of concern.

Corporate engagement is one of the tools included in a recently launched United Nations Principles for Responsible Investment (Principles). Signatories to the Principles agree that ESG issues can affect the performance of investment portfolios. The Principles offer a set of actions for investors to incorporate ESG issues into their investment decision-making with the aim of supporting long term shareholder value creations as well as better aligning investment decisions with the values of investors. More specifically, the Principles include incorporation of ESG issues into investment analysis and decision-making; exercising their rights as active shareholders including voting proxies and engaging corporations in dialogue on issues of concern; encouraging disclosure on ESG issues by fund managers; and agreeing to disclose progress in fulfilling all or some of the Principles. Currently, global signatories to the Principles represent over USD 5 trillion in assets under management and include the Canada Pension Plan Investment Board and Caisse de dépôt et placement du Québec.

A global survey from Mercer Investment Consulting found investment managers predict a growing trend in ESG analysis and active ownership. Mercer's 2005 Fearless Forecast of over 190 investment managers found that almost three-quarters of the managers surveyed predicted that social and/or environmental corporate performance indicators would become mainstream investment considerations within ten years.[11] Further, almost 80% predicted that active ownership, including direct engagement with companies and exercising proxy voting rights, will be a mainstream practice within 5 years.

This survey showed some regional variation and it is interesting to note that investment managers in Canada see trends in active engagement coming much more quickly. Among those surveyed in Canada, 56 percent believe active ownership will be a mainstream practice within the next one to two years. And 80 percent believe incorporation of social and/or environmental (SE) corporate performance indicators will become mainstream within 10 years.

Some roundtable participants have expressed concern that legislated socially responsible investment by UK pension plans has simply become a box-ticking exercise. However, recent survey results from the UK Social Investment Forum tell a

[11] Mercer 2005 Fearless Forecast available at http://www.merceric.com/srisurvey

different story.[12] Findings from the survey conclude that pension trustees strongly believe that over the next 10 years engagement with companies will lead to improvements in the way companies manage impacts and risks. Overall results also found that trustees favour a number of different forms of engagement, including dialogue with companies, positive and negative screening, and exercising proxy voting rights, to implement their responsible investment policies.

In considering appropriate legislation in Canada it is also worth noting a majority of trustees surveyed asked for additional legislation requiring disclosure on how UK pension funds are implementing their Statement of Investment Principles.

Conclusion

Federal government funding to support the development of sector-specific GRI reporting guidelines is a fundamental first step in enhancing ESG disclosure among Canadian extractives companies. With these tools in place companies will be able to fulfill CBCA mandated GRI disclosure and graduated GRI reporting requirements for TSX-listed companies. The capital markets, with support from federal legislation, can help create incentives for business to shift policies and practices to be more responsive to all stakeholders. And concerning pension plans specifically, oftentimes, pensions are not investing in a way that reflects the values of their members. Yet these members are a significant force in the capital markets and through reform to the Pension Plan Act can influence companies to adopt more sustainable business practices. Other governments and markets around the world are rapidly advancing on this issue and we encourage the Government of Canada to consider this set of recommendations closely.

[12] Will UK Pension Funds Become More Responsible, *JustPensions,* 2006 ed.