July 29, 2009

Paul Schneider
Director of Research
Canadian Coalition for Good Governance
120 Adelaide Street West, Suite 2500
Toronto, Ontario
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Re: **Comments on *Building High Performance Boards***

Dear Mr. Schneider:

Northwest & Ethical Investments L.P. thanks the Canadian Coalition for Good Governance (CCGG) for seeking member input on its board governance guidelines, *Building High Performance Boards*. As a long-standing member of the CCGG, with extensive experience evaluating and engaging companies on their environmental, social and governance practice, we would like to offer our comments on the draft guidance.

With $4.0 billion in assets under management, Northwest & Ethical Investments L.P.'s approach to investing incorporates the thesis that companies integrating best environmental, social and governance (ESG) practices into their strategy and operations will provide higher risk-adjusted returns over the long term. Through our proxy voting, corporate dialogues, policy submissions and evaluations we are experienced in encouraging companies to incorporate ESG best practice – including best practice on board governance.

We applaud the CCGG on the thorough and comprehensive guidance in *Building High Performance Boards*, which incorporates a number of best practices that we have embedded in our company evaluations process and our proxy voting guidelines[1]. The CCGG's endorsement of these practices will send a strong signal to companies on the expectations of Canadian institutional investors on board governance. We limit our comments, therefore, to two main recommendations regarding shareholder democracy, and a number of nuance suggestions relating to specific guidelines.

Enhancing Shareholder Democracy

We believe that in addition to the delegated duties already highlighted in the guidelines, directors also have a responsibility to exercise vigilance in respect of shareholder rights.

We recommend that shareholder democracy best practices incorporate a process for directors to ensure that companies are fulfilling their responsibilities to shareholders within the engagement process – including appropriate handling of shareholder resolutions.

In the draft, CCGG highlights seminal events in the evolution of corporate governance in Canada (page 5). Part of that history is the hard-fought battle by shareholders to protect basic rights such as the ability to submit a shareholder resolution under the Canada Business Corporations Act. In the past twelve months, two companies have "lost" shareholder

[1] Our proxy voting guidelines can be found at https://www.ethicalfunds.com/SiteCollectionDocuments/docs/proxy_voting_guidelines.pdf

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proposals that we couriered to them, and for which we had proof of delivery. Shareholder proposals are legal documents, come with legal obligations, and should be treated accordingly. Ignoring a resolution puts the company at risk of legal action. Although proposals are sent to the company's executives, in its oversight capacity the Board should be aware of proposals received, and ensure that the associated obligations are fulfilled.

We suggest that best practices should also include providing access to the proxy ballot to enable shareholders to nominate board candidates.

CCGG encourages High Performance Boards to adopt policies and procedures "over and above the minimum standards established in the regulations created by the Canadian Securities Administrators and corporate law". In this context, we highlight a further issue in the shareholder democracy debate - the right of shareholders to propose their own candidates for the board. Currently, shareholders who wish to propose nominees must do so at their own expense - a daunting and expensive proposition for all but the most determined hedge funds. While no Canadian company currently provides for shareholder access to the proxy ballot, in the US the Chair of the Securities and Exchange Commission is re-opening the debate on this issue[2].

Proposed Guidelines

Turning to the guidelines draft, we offer the following suggestions and responses to the proposed content.

Guideline One: Facilitate Shareholder Democracy
We endorse the proposed guidelines, but offer the following suggestions, in addition to the recommendations on enhancing shareholder democracy already outlined above.

All directors should stand for re-election annually in order that shareholders have an opportunity to reaffirm their support. While this may be implied and perhaps taken for granted, we recommend it should be addressed explicitly.

We agree that shareholders should approve the issue of significant shares. Noting that the draft recommends shareholder approval if the dilution is 20% or more, we suggest that this threshold may not be appropriate in all cases. Depending on the specific circumstances of the company, we may vote against share issues representing lesser dilutions.

Guideline Two: Ensure at least 2/3 of directors are independent
We have no additional recommendations to the proposed guidelines.

Guideline Three: Separate Chair and Chief Executive Officer
We have no additional recommendations to the proposed guidelines. We support the suggestion that the board chair should also be independent of any controlling shareholder.

Guideline Four: Ensure the board has competent and knowledgeable directors
We agree that "a high quality board will have a wide diversity of views and backgrounds, and have a number of directors with direct experience in the industry or industries in which the company operates". As the overseer of management and agent of the shareholders, the board should reflect the diversity of the workforce and of society, thus ensuring that decision-making is enriched by a variety of viewpoints. In this context, we note that various studies point to a positive correlation between gender diversity of the board and financial

[2] See Chair Shapiro's May 20 speech at http://www.sec.gov/news/speech/2009/spch052009mls.htm.

performance: for example, a 2007 report found that Fortune 500 companies with top quartile representation of women on the board outperformed the bottom quartile by 53% in terms of return on equity[3]. Partly to promote diversity, and also to ensure that directors can devote the necessary time to their responsibilities and avoid conflicts of interest, we support the proposed guidance regarding limits on the number of directorships held by any one individual. We vote against directors who sit on more than four boards.

Guideline Five: Establish mandates and independence of board committees
We prefer your guidance alternative that no member of the compensation committee should be a sitting CEO of another company, to avoid exposing the individuals concerned to a potential conflict of interest – the temptation to approve an excessive compensation package in expectation of a quid pro quo.

Guideline Six: Establish reasonable director compensation and share ownership guidelines
We agree strongly that stock options are an inappropriate way to compensate directors. The practice of stock-based compensation in general is becoming a topic of debate: the Dean of the Rotman School of Management has recently questioned its effectiveness for building long-term value[4].

Guideline Seven: Evaluate board, committee and individual director performance
We agree that director's performance should be reviewed and evaluated annually. With regard to specific criteria for evaluating directors, our proxy voting guidelines list several factors that influence our decision to vote against a board nominee. These include evidence that the director has purposely misstated or concealed financial information from the company; evidence that the director consistently acts in the interests of certain shareholders, rather than all shareholders; and the director receiving a high level of withheld votes in previous years.

We strongly endorse the guideline that companies should report on individual director's attendance. In our experience leading companies already provide this type of detailed disclosure to investors. However, lagging companies often simply assure shareholders that all directors have achieved a certain average attendance. This aggregated figure does not allow the shareholder to properly assess individual director's commitment.

We apply a minimum attendance standard of 75%: that is, unless there are extenuating circumstances, we will vote against any board nominee who has missed more than 25% of board (or committee) meetings in the past year. Our most recent company evaluations indicate that only a small minority of companies listed on the TSX had at least one director who attended less than 75% of the meetings. We recommend, therefore, that the guidelines include a suggested minimum expectation for director attendance of 75% - this would give lagging companies a target to aim for.

Guideline Eight: Provide oversight in strategic planning, risk management and hiring and evaluating management
According to recent research by Governance Metrics International, standardized disclosure on risk management is lacking at most companies; risk committees of the board are even

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[3] Lois Joy, Nancy Carter, Harvey Wagner & Sriram Narayanan (2007) *The Bottom Line: Corporate Performance and Women's Representation on Boards* http://www.catalyst.org/publication/200/the-bottom-line-corporate-performance-and-womens-representation-on-boards
[4] Roger Martin, "Scrap stock-based compensation and go back to principles", *Harvard Business Review* website, July 10, 2009 http://blogs.harvardbusiness.org/hbr/how-to-fix-executive-pay/2009/07/scrap-stock-based-compensation.html

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less common in many sectors; and few directors have risk management experience[5]. In this context, and against the background of the current economic crisis, we welcome the focus in this section of the draft on enterprise risk management, which we see as an essential tool for building and maintaining long-term company value. We agree that identifying the risks of the business and monitoring management's execution of the business strategy should be a core function of the board, rather than delegated to the Audit Committee.

We are concerned, however, that if risk management is only considered at the full board level, it may not be considered in sufficient depth. What is the responsibility of all may receive the full attention of none. To ensure this vital issue is not trivialized, it is preferable to establish a specific board committee for risk management. Guideline Five applies here: good practice on establishing mandates and independence of committees should be extended to risk management committees, empowering them to address and sound the alarm on threats to long-term value that might otherwise be underplayed within a bonus-dependent management culture.

We appreciate the reference to the need for the board to provide direction on non-financial goals, but would recommend more specific reference to the need for recognition and management of environmental, social and governance (ESG) risks. As noted earlier, our approach to investing incorporates the thesis that companies integrating ESG best practices into their strategy and operations will provide higher risk-adjusted returns over the long term. Increasingly, directors and executives share this perspective: in a 2004 Deloitte survey, 92% responded that financial indicators alone do not adequately capture their company's underlying strengths or vulnerabilities[6].

Guideline Nine: Assess the Chief Executive Officer and plan for succession
We have no additional recommendations to the proposed guidelines.

Guideline Ten: Develop and oversee executive compensation plans
As the CCGG will be aware from our earlier submissions on this topic, we see executive compensation as a key governance issue[7]. We are especially heartened to see the CCGG address in these guidelines potential conflicts of interest for compensation consultants, an issue we raised in our comments on the CCGG *Executive Compensation Principles*[8]. We would strongly agree that consultants "should align their interests solely with the interests of the shareholders of the company, and not have any other interests that would conflict with the interests of shareholders".

We also agree that compensation should be linked to risk management: as we have noted earlier, risk management should include relevant non-financial risks. We take this opportunity to endorse the concept of linking executive compensation to relevant long-term financial <u>and</u> non-financial performance metrics, as articulated under Principle 2 of the CCGG's *Executive Compensation Principles*[9].

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[5] http://www.gmiratings.com/Release_GMI_Boards_Risk_Oversight_6_29_09.pdf
[6] Deloitte (2004) *In the Dark: What Boards and Executives Don't Know About the Health of Their Businesses* http://www.deloitte.com/dtt/cda/doc/content/dtt_audit_InthedarkFINAL2_101304.pdf
[7] Details of some of our recent work on this issue can be found at https://www.ethicalfunds.com/SiteCollectionDocuments/docs/Executive%20Compensation%20Summary%20090708%20final.pdf.
[8] Our submission can be found at https://www.ethicalfunds.com/SiteCollectionDocuments/docs/Canadian_Coalition_for_Good_Governance_Executive_Compensation.pdf.
[9] http://www.ccgg.ca/media/files/guidelines-and-policies/compensation/CCGG-ECP-FINAL-June2.pdf.

Guideline Eleven: Report governance policies and initiatives to shareholders
Increasingly, research shows that companies following corporate governance best practices have better returns[10]. Consequently, disclosure on corporate governance is material information for investors. To this end we agree strongly that the extent to which the issuer complies with each of the CCGG guidelines should be disclosed. Establishing mandates provides clarity to executives and board members, but only through disclosure of mandates and of the extent of the company's adherence to them will shareholders have access to the information they need to guide their decision-making.

Guideline Twelve: Engage shareholders outside the annual meeting
As implementers of Canada's most comprehensive shareholder action program, we concur with the CCGG's view that effective engagement with shareholders must extend beyond the Annual General Meeting (AGM). While the ability to file and vote on resolutions is a cornerstone of shareholder rights, it also represents the last resort in terms of exercising shareholder voice. Effective engagement should also encompass issuer interaction before the AGM and throughout the year. We encourage the CCGG to pursue its exploration of what constitutes good practice in ongoing engagement with shareholders.

We would also like to take this opportunity to commend the CCGG for clarifying its position on "say on pay" to recognize explicitly the value of the advisory vote on executive compensation. As you will be aware from our earlier submissions on this topic[11], we have long believed that shareholders should have a voice in executive compensation, and "say on pay" is one tool in that process.

Conclusion

We commend the CCGG for offering members the opportunity to comment on its governance best practice guidelines for boards. We believe the shareholder democracy guidelines could be enhanced by reference to the directors' responsibility to ensure that basic shareholder rights, such as the right to file resolutions, are respected; and by including access to the proxy ballot as an emerging best practice. In general, however, we endorse the contents of *Building High Performance Boards*. Companies following the guidelines would be providing convincing evidence to investors of their commitment to board excellence.

Please do not hesitate to contact us for further discussion on the issues raised in this submission.

Sincerely,

Northwest & Ethical Investments L.P.

Robert Walker,
Vice President, Sustainability

[10] For example: Ken Spellman & Robert Watson (2009), *GMI Ratings and Corporate Governance Performance: 2003 to 2008*, available at SSRN: http://ssrn.com/abstract=1392313
[11] Our earlier submissions dealing with "say on pay" can be accessed at https://www.ethicalfunds.com/SiteCollectionDocuments/docs/Canadian_Coalition_for_Good_Governance_Executive_Compensation.pdf and https://www.ethicalfunds.com/SiteCollectionDocuments/docs/CCGG_say_on_pay_response.pdf