March 18, 2009

Stephen Griggs
Executive Director
Canadian Coalition for Good Governance
120 Adelaide Street West, Suite 2500
Toronto, Ontario
M6H 1T1

Re: **Comments on Draft Executive Compensation Principles**

Dear Mr. Griggs,

Northwest & Ethical Investments L.P. would like to commend the Canadian Coalition for Good Governance (CCGG) for updating its Executive Compensation Principles, and for seeking input into those principles. As a long-standing member of the CCGG, with extensive experience evaluating and engaging companies on their environmental, social, and governance practices, we would like to offer our comments on the draft Principles.

With $3.6 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 company evaluations we have extensive experience in encouraging companies to incorporate ESG best practices – including best compensation practices. For example, in both 2006 and 2007 we wrote to every company on the TSX Composite Index regarding their implementation of processes promoting transparency and accountability in executive compensation decisions. Our comments below indicate why executive compensation should be linked to ESG considerations and how this can be reflected in the CCGG Principles.

Compensation Practices in Canada

The Principles outlined by the CCGG in the January 9, 2009 draft provide a solid basis for improving compensation practices in Canada. We do suggest, however, that the CCGG include in the Principles three additional concepts each designed to promote long-term value creation: rewarding executives for long-term sustainable performance, encouraging independence in the decision-making process, and promoting greater accountability to shareholders.

Recommendation 1: Pay for Long-term Sustainable Performance

We support the draft's focus on "rewarding executives for adding value to the company through superior risk-adjusted performance". In recent months, however, we have witnessed across the global economy the negative consequences of an excessive reliance on short-term financial metrics as the primary indicator of corporate performance.

We believe the Principles should link compensation to performance against sector-specific ESG performance metrics.

We are not alone in suggesting that relying exclusively on financial indicators provides an incomplete picture of a corporation's ability to generate value over the long term. In a 2004 Deloitte survey[1] of 250 directors and executives, 92% responded that financial indicators by themselves do not adequately capture their company's underlying strengths or vulnerabilities. Indeed, an exclusive focus on short-term financial metrics can be a disincentive to promoting the long-term health of the company. A 2004 study revealed that due to the negative market reaction associated with missing quarterly earnings targets, 80% of executives would give up creating long-term value in exchange for smooth quarterly earnings[2].

Executive compensation plans based upon short-term financial metrics – to the exclusion of other measures of corporate performance – can distort incentive mechanisms and hobble the ability of executives and directors to build healthy corporations. To remedy this situation, we believe compensation plans should include metrics that provide a more complete and forward-looking picture of corporate health. Many stakeholders share this perspective: a recent McKinsey survey commissioned by the CCGG found that an overwhelming majority of directors and investors wished to see factors such as sustainable development and customer satisfaction considered in setting compensation.

From our in-house evaluations of Canadian companies' systems and performance, we are aware that some companies are already linking executive compensation to sector-specific ESG-related criteria.

- At the Bank of Nova Scotia, executive bonuses are based on metrics including good governance, employee satisfaction, customer satisfaction, and commitment to corporate social responsibility.
- At Canadian National Rail, bonuses are based on criteria such as safety, customer service, and human resource management.
- At Arc Energy, executive compensation is linked to Environment, Health and Safety performance.

In each of these cases, the company has deemed industry-specific non-financial criteria to be essential to the long term health of the company and it encourages performance on these criteria by embedding them into compensation decisions.

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[1] *Annette Watson – Deloitte - "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

[2] John R. Graham, Campbell R. Harvey, and Shiva Rajgopal, "The Economic Implications of Corporate Financial Reporting", *Journal of Accounting and Economics*, April 2004.

Recommendation 2 – Independence in Compensation Decision-making

In recent months, we have witnessed compensation committees recommending pay packages for top executives that the recipients themselves rejected as excessive. Even more egregiously, at one of Canada's major banks the compensation committee recommended the CEO receive a raise - after the company's share price had declined significantly, net income had decreased and the bank had to write down assets. Investors expect the compensation committee to make rational and appropriate assessments – they should not have to rely on the top executives to make the right decision on their own compensation. This requires a truly independent compensation committee with a process beyond reproach.

We believe the Principles should eliminate conflicts of interest in the compensation decision-making process.

Northwest & Ethical Investments L.P. promotes a number of practices to address this including the following:

- Given the growing body of literature questioning the independence of compensation consultants[3], we encourage companies to disclose fees paid to compensation consultants, as well as any potential conflict of interest embodied by the consultant firm.
- Additionally, as interlocking directorships could create temptation to support inappropriate compensation packages in expectation of a quid pro quo, we encourage companies to avoid appointing to the compensation committee directors who serve as the CEO of another company.

At Northwest and Ethical Investments L.P., we have embedded these two principles into our Proxy Voting Guidelines[4]. In 2008, we voted against management over 30 times due to violations of the compensation committee's independence.

Recommendation 3 - Accountability to Shareholders

We believe that the health of our investments depends on holding executives accountable. 'Say on pay' (providing shareholders with a non-binding vote on the executive compensation package) is now mandatory in the UK, is spreading in the United States, and is gaining momentum in Canada. Recently, several 'say on pay' shareholder resolutions achieved majority support at major Canadian banks. In the face of such support, a growing number of banks and other financial companies have agreed to adopt advisory votes. These developments surely reflect increased expectations among investors with respect to compensation accountability.

We believe the Principles should hold executives accountable by providing shareholders with an advisory vote on executive compensation.

As presented, the Principles do not address the issue of accountability to shareholders adequately. No support is expressed for 'say on pay'. The draft currently states that

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[3] In December 2007, the US House of Representatives Committee on Oversight and Government Reform examined this issue and found widespread conflicts of interest.
A 2008 study at Wharton found that executives get paid more when compensation consultants are hired. See the abstract at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1103682

[4] See https://www.ethicalfunds.com/SiteCollectionDocuments/docs/proxy_voting_guidelines.pdf

"constructive engagement with boards and compensation committees to explain the shareholders' perspective on compensation practices and disclosure is preferable to a 'Yes' or 'No' advisory vote." While we also place the highest value on constructive consultation, there is currently no other practical forum or structure for most shareholders to offer feedback on compensation, apart from an advisory vote. We suggest, therefore, that the CCGG should recognize and endorse 'say on pay' within the Principles. Your recent statements on the issue encourage us to believe that this will be addressed in the final version[5].

In conclusion, with the global financial crisis focusing more attention than ever on this issue, we welcome the CCGG's timely initiative to update its Executive Compensation Principles. The draft constitutes a solid basis, but would be enhanced by incorporating emerging good practices in the areas of rewarding executives for long-term sustainable performance, encouraging independence in the compensation decision making process, and promoting accountability to shareholders. We believe the Principles should recognize and support the initiatives of corporate leaders on executive compensation - and push the laggards to catch up.

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

Sincerely,

Northwest & Ethical Investments L.P.

Bob Walker,
Vice President Sustainability

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[5] *Globe and Mail*, February 26, 2009, "National Bank shareholders get say on pay"
National Post, February 26, 2009, "Shareholder revolt over bankers' pay"