March 15, 2010

Stephen Davis & Erik Breen
Co-Chairs, ICGN Taskforce on Corporate Risk Oversight Principles Review Working Group
ICGN Secretariat
16 Park Crescent
London W1B 1AH
UK

**Re: Membership Consultation on ICGN Corporate Risk Oversight Principles**

Dear Mr. Davis and Mr. Breen:

With S4.3 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 company evaluations, our active engagement with the companies in our funds, and our issues research, we have developed considerable insight into good practices and weaknesses in corporate ESG disclosure and practice, and we value opportunities to share this experience in the context of consultations on guidelines and standards.

Given the role that faulty risk management played in the recent financial crisis, we welcome ICGN's focus on the important question, "how can an investor judge if a corporate board is effectively overseeing risk management?"

Our comments on the ICGN Corporate Risk Oversight Principles follow the structure of the Principles draft, where appropriate referencing your specific questions.

## 1. Preamble

*Q1: Have all appropriate areas been covered?*

The preamble could be made more consistent with the 2009 ICGN Global Corporate Governance Principles[1], the first principle of which states that the corporate objective should be sustainable value creation: "sustainability implies that the company must manage effectively the governance, social and environmental aspects of its activities as well as the financial". The preamble rightly points out that "risk and risk oversight must be understood broadly", and makes reference to "long-term financial stability and non-financial progress" (p4). But it does not spell out clearly that companies, boards and investors should be focusing on risk and opportunity, not only in the financial sphere, but also in the environmental, social and governance spheres. Boards cannot oversee risk effectively, nor can investors judge that oversight, if they lack a complete perspective on the potential scope of corporate risk.

To provide further context it may also be helpful to touch briefly on typology of risk (e.g. strategic, operational, regulatory, litigation, reputational, stakeholder, etc) and the need for the company to focus on the most significant risks and opportunities.

[1] http://www.icgn.org/files/icgn_main/pdfs/best_practice/global_principles/icgn_global_corporate_governance_principles-_revised_2009.pdf

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The topic of the document is a specific aspect of the risk question: how investors can judge if boards are overseeing risk effectively. At times the focus appears to expand to wider questions of risk management, and how investors should deal with the issue of risk internally. If the intention is to maintain the narrow focus on risk oversight by the board, some of the present content may not be required; conversely, if the intention is to deal with the wider question of risk, further content may be required.

Given that this is a principles document, it may be desirable to articulate the desired risk oversight outcomes at each level of the document, before detailing some of the good practices that might lead to those outcomes. As an example: the good practice of having a risk committee consisting of a diverse group of independent board members is targeted at the outcome of the board being capable of taking a comprehensive, long-term view of potential risks and opportunities that could be overlooked or underplayed within the prevailing management culture of the company.

## 2. Corporate Risk Oversight

### 2.1 Board and company process

One important point seems to be missing from this section: the board needs to ensure the compensation regime is aligned with the company's strategy, risk appetite and risk management priorities. This is touched upon in the disclosure section that follows, but obviously needs to form part of the risk oversight process before that disclosure is possible. It goes without saying that the attitude of management and employees towards risk is guided by the way that they are rewarded.

The draft does not bring out the reasons why it may be desirable to install a dedicated risk committee of the board. We would agree that "in the event a risk committee is installed, responsibility for risk oversight still resides with the full board". However, 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.

Committees focusing on risk management should be empowered to address and sound the alarm on threats to long-term value that might otherwise be underplayed within a management culture that could be overly-focused on short-term results. For this reason, we attach great importance to the independence and diversity of the board members appointed to the board in general, and to the risk committee specifically. The language on the importance of the role of non-executive board members in risk oversight could be strengthened.

Current practice is that risk oversight is often delegated to the audit committee, with the possible consequence that a narrow financial perspective on risk will prevail. Once again, it may be desirable to reiterate clearly in this section that enterprise risk comprehends all aspects of ICGN's concept of corporate sustainability – financial, environmental, social and governance considerations.

According to recent research by Governance Metrics International (GMI), only 1% of companies within their global survey group had an independent director with generalized risk management expertise[2]. Where a board lacks this competency, investors should be looking for evidence that it is pursuing it actively through training or selection.

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[2] http://www.gmiratings.com/Release_GMI_Boards_Risk_Oversight_6_29_09.pdf

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**2.2. Board and company disclosure**

Once again, disclosure on risk management oversight should demonstrate clearly that the board understands that scope of corporate risk and opportunity – that it covers not only financial matters, but also environmental, social and governance issues, and that underlying risk can manifest in different forms (operational, reputational, etc).

From our experience of evaluating corporate disclosure on risk oversight by Canadian companies, we conclude that such disclosure is generally weak. The financial sector has the best-developed disclosure, but this can be attributed to more specific standards in this area, and the fact that risk oversight and management are generally seen as intrinsic to the business. Given the scale of the need for improvement, we believe investors should be prioritizing efforts to stimulate improved risk oversight - and management - in the sectors that face the highest risks, such as extractive industry. Informed investors, who will likely to be monitoring disclosure at various companies within a sector, are well-placed to point out to companies where they may be lagging behind their industry peers.

**2.3 Investor responsibility**

At some points in this section it becomes unclear whether the focus of the draft is on investor capacity to monitor portfolio companies for risk oversight, for risk management, or for risk in general. In fact investors should have capacity for all of the above, but in the context of this draft it may be helpful either to narrow the focus, or to break down the section according to these different aspects of risk monitoring.

Investors should indeed ensure they have the both the competence and the systems in place to consistently monitor corporate risk oversight, and should provide disclosure to beneficiaries on this – but this should form part of wider disclosure on how they monitor and take action on all relevant aspects of corporate risk in portfolio companies. An important initial step in this process is to provide clarity about the institution's investment mandate and policies, and its own attitude towards risk.

Given our strong commitment to shareholder action, we welcome the clear acknowledgment of an investor responsibility not only to monitor risk oversight by portfolio companies, but to actively challenge and dialogue with companies where there is doubt about the quality of risk oversight.

*Q10: What skills are requisite for the engagement process?*

Our Sustainability team of 11 staff runs Canada's largest and most comprehensive shareholder engagement program. From our experience, we believe that effective engagement depends on understanding the issues facing different corporate sectors and the specific companies within those sectors. This implies that the investor should have access to wide-ranging expertise, not only in the financial field of but also on environmental, social and governance issues. Results take time, and demand deep, respectful dialogue and a great deal of persistence. Obviously, this means investing adequate resources in the capacity to carry out this work. We see little evidence that the majority of Canadian investment institutions are devoting significant resources to building capacity for effective engagement, either internally or by contracting external expertise.

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**2.4 Interaction between board and investor**

*Q14: Who are the right people to have these interactions?*

It is difficult to be prescriptive about which are the right positions within investor organizations to conduct shareholder dialogue about risk oversight, given the varied structures of different institutions. It is perhaps better to focus on the competencies required to conduct such dialogue effectively. In our experience, respect, trust, skill, professionalism and knowledge of the issues are often deemed more important by the companies we engage than the seniority of the investor institution staff member who is conducting the engagement.

If the topic of engagement is risk oversight specifically, dialogue with the board is clearly a priority. But once again, it is probably unwise to be too prescriptive about who investors should dialogue with. Companies are made up of individuals, and corporate champions can be found at different levels of the organization.

*Q15: Will code of practice or regulatory mandate be most effective?*

Corporate leaders and responsible investors are likely to respond to voluntary guidelines on good practices. Others will tend to wait until practices are either very widely adopted, or mandatory. Looking at the Canadian landscape, standards of risk oversight disclosure are clearly higher in the financial sector, where requirements are stricter.

Once again, thank you for the opportunity to comment on the Principles. Please do not hesitate to contact us for further discussion on any of the issues raised.

Sincerely,

**Northwest & Ethical Investments L.P.**

Bob Walker,
Vice President, Sustainability

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