



May 12, 2014

Ms. Kerrie Waring  
Managing Director  
International Corporate Governance Network  
Saffron House  
6-10 Kirby Street  
London, EC1N 8TS  
United Kingdom

Sent by email

**Re: Draft ICGN Global Governance Principles**

Dear Ms. Waring:

We are writing in response to the International Corporate Governance Network (ICGN) request for member comments on its Draft ICGN Global Governance Principles.<sup>1</sup>

With approximately C\$6 billion in assets under management, NEI Investments' approach to investing incorporates the thesis that companies integrating best environmental, social and governance (ESG) practices into their strategy and operations will build long-term sustainable value for all stakeholders and provide higher risk-adjusted returns to shareholders.

NEI Investments is a member of the Canadian Coalition for Good Governance (CCGG), and we draw attention to the separate submission from CCGG, while offering the following additional comments.

- 1. Do you have any comments regarding the drafting of the Preamble which aims to clarify the objective of the Principles and to whom they should apply?*

**A corporate objective that embraces ESG and stakeholder theory**

We recommend that the initial section defining the corporate objective included in the 2009 ICGN Global Corporate Governance Principles<sup>2</sup> should be reinstated.

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<sup>1</sup> ICGN (2013). Draft ICGN Global Governance Principles [https://www.icgn.org/images/ICGN\\_Member\\_Consultation.pdf](https://www.icgn.org/images/ICGN_Member_Consultation.pdf)

<sup>2</sup> ICGN (2009). Global Corporate Governance Principles: Revised.  
[https://www.icgn.org/images/ICGN/files/icgn\\_main/Publications/best\\_practice/global\\_principles/ICGN\\_Global\\_Corporate\\_Governance\\_Principles\\_2009\\_July\\_2013\\_re-print.pdf](https://www.icgn.org/images/ICGN/files/icgn_main/Publications/best_practice/global_principles/ICGN_Global_Corporate_Governance_Principles_2009_July_2013_re-print.pdf)

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It is a widespread belief that the main purpose and obligation of a publicly-traded company, and by extension the key duty of its directors, is to benefit shareholders by maximizing the share price. This “shareholder primacy” perspective has been the dominant theory of the firm for several decades. While shareholder primacy drives much investment thinking, its legal foundations are weak at best.

In the Canadian context, Section 122 (1) (a) of the Canada Business Corporations Act states: *“Every director and officer of a corporation in exercising their powers and discharging their duties shall act honestly and in good faith with a view to the best interests of the corporation.”*<sup>3</sup> In *Peoples Department Stores Inc. (Trustee of) v. Wise*, the Supreme Court of Canada ruled: *“[I]t is clear that the phrase the ‘best interests of the corporation’ should be read not simply as the ‘best interests of the shareholders’... We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments, and the environment.”*<sup>4</sup>

Stakeholder theory holds that the purpose of the corporation is to create value for all its stakeholders. It has found support in law, management theory and from many people who actually run companies. Managers taking the long view and considering the interests of a broad set of potential beneficiaries can reduce risks, lower costs and exploit opportunities that contribute to the long-term health of the companies they run.<sup>5</sup>

The 2009 Global Corporate Governance Principles begin with a statement (section 1.0) on the objective of companies, which is defined as *“sustainable value creation”*. This section stresses the importance of managing all aspects of sustainability (financial, environmental, social and governance) and relationships with key stakeholders, *“such as employees, suppliers, customers, communities and the environment as a whole”*, as well as delivering long-term returns to shareholders.

We appreciate the way in which references to corporate environmental and social responsibilities, and to business ethics and integrity, have been enhanced and integrated throughout the Draft Principles. We believe, however, that to provide context for what comes later, there is value in including once again a clear statement at the start of the document defining the corporate purpose in a way that clearly embraces ESG considerations and stakeholder theory, and is not limited to a shareholder primacy perspective.

2. *Do you have any comments with regard to the drafting of the principles in ‘Section 1: Boards’ and are there any other recommendations you believe that the ICGN should include?*

### **Broadening the perspective on diversity (Section 3.6)**

Our perspective on the value of diversity embraces not only gender and ethnicity but also other attributes such as aboriginal status, sexual orientation and disability, as well as representation of different age groups. In addition, we advocate for companies to recruit directors with wider diversity of experience and expertise, including environmental, social and governance issues that are material to the business.

<sup>3</sup> Government of Canada. Canada Business Corporations Act (R.S.C., 1985, c. C-44). <http://laws-lois.justice.gc.ca/eng/acts/C-44/>

<sup>4</sup> CanLII. Peoples Department Stores Inc. (Trustee of) v. Wise, 2004 SCC 68, [2004] 3 SCR 461. <http://www.canlii.org/en/ca/scc/doc/2004/2004scc68/2004scc68.html>

<sup>5</sup> More detail on our perspectives on the stakeholder theory/shareholder primacy debate can be found in the following report: NEI Investments (2012). Crisis, What Crisis? [https://www.neiinvestments.com/Documents/Research/Exec\\_Comp\\_English\\_Final.pdf](https://www.neiinvestments.com/Documents/Research/Exec_Comp_English_Final.pdf)



We welcome the reference to specific and measurable targets for gender and ethnic minority representation, and would like to see both these aspects of diversity enhanced on boards and in senior management. However, we would prefer more inclusive language, making reference to both women and men, and to ethnic diversity. A board that consisted entirely of women, or of members of a particular ethnic minority community, would be no more diverse than present boards that consist entirely of men from the majority ethnic group.

### **Equitable compensation (Section 6.6)**

We suggest that ICGN should add a reference to the responsibility of the board and compensation committee to ensure that executive compensation is perceived as reasonable and equitable by employees at other levels in the company, and by external stakeholders.

We believe excessive and inequitable compensation represents a threat to sustainable value creation. Increasing pay disparity within companies is not only a fairness issue, but also a potential business risk. A disconnect between the pay of the CEO and other senior executives may point to an undesirable concentration of power or poor succession management. A disconnect between executive compensation and salaries at lower levels of the company may demotivate employees, and thus undermine the strategic objective of attracting and retaining talented people. Concerns have also been raised that compensation design and high pay levels for top executives do not take into account how people are actually motivated and lead to needlessly complex pay disclosure in proxy circulars. Prevailing approaches to executive compensation have led inexorably to excessive levels of executive compensation. High pay, in turn, is contributing to greater income inequality, which has been identified as a key threat to economic and social stability. Mechanisms for curtailing excessive compensation are gaining traction in some jurisdictions.<sup>6</sup>

Increasingly, we are looking for evidence in the proxy circular as to whether the compensation committee is solely focused on setting compensation for senior executives, or is undertaking oversight of human resources questions across the company, including strategy on equitable pay.

Equitable compensation has been a focus of our corporate engagement program for the past several years. Following dialogue, a number of Canadian companies have begun to enhance disclosure on equitable compensation questions in their 2014 proxy circulars, including the largest Canadian banks and the telecommunications services issuer TELUS.<sup>7</sup>

### **Fair representation of vote outcomes (Section 8.2)**

Where the procedure is not regulated, the board should ensure that the outcome of votes is not only reported, but also presented in a fair and consistent way. For example, non-votes should not be included in the denominator nor considered as votes in support of management, and “abstain” votes on shareholder proposals should be reported separately, and not added to the total of votes either “for” or “against” the proposal. When we abstain on a shareholder proposal, generally it is

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<sup>6</sup> An outline of our concerns relating to equitable compensation can be found in the following short report: NEI Ethical Funds (2013). Quantum Shift: Engaging on Internal Pay Equity and Income Inequality at Canada's Banks.

[http://www.ethicalfunds.com/Documents/ExecutiveCompUpdate\\_revisedMay15.pdf](http://www.ethicalfunds.com/Documents/ExecutiveCompUpdate_revisedMay15.pdf)

<sup>7</sup> See, for example:

- Royal Bank of Canada (2014). 2014 Proxy Circular. <http://www.rbc.com/investorrelations/pdf/2014englishproxy.pdf> (p27)
- Bank of Nova Scotia (2014). 2014 Proxy Circular. [http://www.scotiabank.com/ca/en/files/14/03/BNS\\_PROXY\\_CIRCULAR\\_ENGLISH.pdf](http://www.scotiabank.com/ca/en/files/14/03/BNS_PROXY_CIRCULAR_ENGLISH.pdf) (p22)
- TELUS (2014). 2014 Information Circular. [http://about.telus.com/servlet/JiveServlet/downloadBody/5383-102-1-5855/Info%20circular%202014%20\(EN\).pdf](http://about.telus.com/servlet/JiveServlet/downloadBody/5383-102-1-5855/Info%20circular%202014%20(EN).pdf) (p49)



because we consider the topic of the proposal to be important, but in our opinion neither the solution put forward by the proponent nor the rebuttal by the company is fully convincing. In this situation, our abstention is a considered and deliberate act, and we explain our viewpoint in our proxy voting disclosure.

### **The corporate “responsibility to respect” human rights (additional)**

We recommend that the Draft Principles address specifically the duty of directors relating to oversight of the company’s efforts to fulfill the corporate “responsibility to respect” human rights set out in the 2011 UN Guiding Principles on Business and Human Rights.<sup>8</sup>

The UN Guiding Principles make it clear that the “responsibility to respect” extends to all businesses: it is *“a global standard of expected conduct for all business enterprises wherever they operate”* (paragraph 11) that *“applies to all enterprises regardless of their size, sector, operational context, ownership and structure”* (paragraph 14).

The Guiding Principles outline a specific set of actions that companies should undertake (paragraph 15): *“In order to meet their responsibility to respect human rights, business enterprises should have in place policies and processes appropriate to their size and circumstances, including: (a) A policy commitment to meet their responsibility to respect human rights; (b) A human rights due-diligence process to identify, prevent, mitigate and account for how they address their impacts on human rights; (c) Processes to enable the remediation of any adverse human rights impacts they cause or to which they contribute.”*

It is also specified that the human rights policy should be approved at the most senior level, and embedded throughout the enterprise (paragraph 16).

The present lack of clarity within basic legal and policy frameworks that govern business behaviour regarding what companies may or must do in order to ensure respect human rights is highlighted, with the recommendation that *“laws and policies in this area should provide sufficient guidance to enable enterprises to respect human rights, with due regard to the role of existing governance structures such as corporate boards”* (paragraph 3). Against this background, it would be appropriate and helpful for ICGN to make specific mention of the role of the board in oversight of human rights policy.

3. *Do you have any comments with regard to the drafting of the principles in ‘Section 2: Investors’ and are there any other recommendations you believe that the ICGN should include?*

### **The shareholder “responsibility to respect” human rights (additional)**

ICGN should also consider adding a specific reference to the need for human rights due diligence by investment institutions. For several years, we have been advancing the position that the “responsibility to respect” also extends to investors.<sup>9</sup> In the past year it has been confirmed in international fora that both the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises apply to the financial sector just as they do to all other sectors, and specifically that they have application for minority shareholders.<sup>10</sup>

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<sup>8</sup> United Nations (2011). Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework. <http://www.ohchr.org/documents/issues/business/A.HRC.17.31.pdf>

<sup>9</sup> See, for example: NEI Investments (2012). Re: Call for input: Report on business and human rights and the UN system. <https://www.neiinvestments.com/Documents/PublicPolicyAndStandards/2012/Business%20and%20Human%20Rights%20Framework%20Implementation%20UN%20System.pdf>

<sup>10</sup> See, for example:

We do not believe that efforts to integrate ESG to the traditional concept of fiduciary duty suffice to ensure that investment institutions will fulfill the “responsibility to respect”. There has been increasing acceptance of the position that fiduciaries can and should take into account all factors that may be material to the performance of assets under their control – including ESG factors.<sup>11</sup> Companies with poor performance on human rights may face operating restrictions, litigation, reputational damage, and erosion of the social license to operate. As a result, many investors now identify human rights issues as material risks to the value of companies, and accept that good fiduciaries should take them into account in investment decision-making. However, this does not equate to a universal responsibility to respect human rights at all times. If it is not generally accepted that investment institutions have a duty to support public companies to respect human rights, human rights measures undertaken by management of a public company could be opposed by some or all of the company’s shareholders, because they are seen as contrary to profit maximization, or because the risks the measures are intended to address are not considered to be material.

### **Corporate engagement code of conduct (additional)**

The Draft Principles address investor responsibilities toward clients and beneficiaries, but are largely silent on ethics within the corporate engagement process. In this context, we note that NEI Investments has developed and disclosed a code of conduct for engaging external parties, covering relations with stakeholders including companies and communities affected by the issues on which we engage.<sup>12</sup>

### **Feedback to issuers (Section 14.1)**

We make our proxy voting decisions and rationale available in the public domain soon after we have voted. We did so for our Ethical Funds family long before this became obligatory for Canadian mutual funds, in the belief that our unit holders had the right to know how we were voting, and why. It is therefore possible for issuers to explore our voting and contact us if they have questions. We continue to question why other institutional investors, such as pension funds, endowments and foundations, are not subject to the same voting disclosure requirements as mutual funds.

We also devote considerable effort to providing proactive feedback to issuers on key votes such as the advisory vote on executive compensation. Each year we write several dozen detailed proxy voting feedback letters, targeting our larger holdings, as well as responding to companies that reach out to us. However, as we vote thousands of items at hundreds of meetings every year, realistically we cannot provide feedback proactively to every issuer in our holdings.

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- OECD (2013). Global Forum on Responsible Business Conduct, 26-27 June 2013 – Summary Report. [http://mneguidelines.oecd.org/globalforumonresponsiblebusinessconduct/2013GFRBC\\_SummaryReport.pdf](http://mneguidelines.oecd.org/globalforumonresponsiblebusinessconduct/2013GFRBC_SummaryReport.pdf).
  - OECD National Contact Point Norway (2013). ForUM vs. NBIM Final Statement. <http://www.responsiblebusiness.no/en/assessment-of-complaints/nbim/>
  - OECD National Contact Point Netherlands (2013). ABP/APG – SOMO/Both Ends. <http://www.oesorichtlijnen.nl/sites/www.oesorichtlijnen.nl/files/final-statement-somo-bothends-apg-abp.pdf>

<sup>11</sup> The Freshfields report, conducted under the auspices of UNEP-FI, is widely regarded as the most authoritative argument for the legality of considering ESG issues in investment decisions. The report, and its 2009 follow-up, recognized that the definitions of moral and legal standards of behaviour are in constant evolution.

- Freshfields (2005). A legal framework for the integration of environmental, social and governance issues into institutional investment. [http://www.unepfi.org/fileadmin/documents/freshfields\\_legal\\_resp\\_20051123.pdf](http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf)
- UNEP FI (2009). Fiduciary Responsibility II: Legal and practical aspects of integrating environmental, and social and governance issues into institutional investment. <http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf>

<sup>12</sup> The most recently published version of the Code of Conduct, which is currently undergoing a periodic review process, can be found here: [https://www.neiinvestments.com/Documents/Accountability/3%20SI\\_Program\\_Code\\_of\\_Conduct%203.pdf](https://www.neiinvestments.com/Documents/Accountability/3%20SI_Program_Code_of_Conduct%203.pdf)



## Conclusion

In conclusion, we thank the secretariat, board and committee chairs for developing the draft, and commend ICGN for seeking comments from members. We view the Draft Principles positively, and reiterate the following recommendations:

- include a statement of the corporate objective that embraces ESG and stakeholder theory;
- integrate the “responsibility to respect” human rights of both boards and investors;
- broaden the perspective on diversity and make it inclusive;
- include a reference to the board’s responsibility for oversight of equitable compensation; and
- include the board’s responsibility to ensure fair representation of vote outcomes.

If you have any questions regarding this letter, please do not hesitate to contact **Michelle de Cordova, Director, Corporate Engagement & Public Policy** ([mdecordova@neiinvestments.com](mailto:mdecordova@neiinvestments.com) 604-742-8319).

Sincerely,

**NEI Investments**

A handwritten signature in black ink, appearing to read "Robert Walker", with a long horizontal line extending to the right.

Robert Walker  
Vice President, ESG Services and NEI Ethical Funds

CC:

Board of Directors, NEI Investments

Ms. Michelle de Cordova, Director, Corporate Engagement & Public Policy, NEI Investments