

January 20, 2016

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

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Sent by email

**Re: ICGN Global Stewardship Code**

Dear Ms. Waring:

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

With approximately C\$5.2 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.

1. *Do you agree or disagree with the stated purpose of the ICGN Global Stewardship Code? Are there other applications you might envisage?*

Our observations on the suggested applications of the Code are as follows:

- *Serve as an international “passport” for institutional investors seeking to signal their stewardship policies and practices either when investing in markets without stewardship codes or when they invest in multiple markets with differing codes.* We assume that this signalling is primarily directed at investee companies. In our engagement experience, most companies value the chance to learn more about the investment philosophy and practice of their investors. We endeavour to share our perspective with as many companies as possible, but it is challenging to reach out to every company, particularly in the case of smaller holdings in distant markets. Therefore, we are sympathetic to this application of the Code. However, we feel that it merits further discussion, particularly with respect to the assertion that it is not practical for investors to be signatories of stewardship codes in every country they invest in. The practical challenge is undeniable, but what responsibility does an international investor then have to uphold standards in other markets, particularly if they are higher than those of the investor's domestic market; and how can governance be most effectively improved in markets that are lagging in this area? We discuss this further in our comments on the Principles below.
- *Serve as a point of reference for investors on what stewardship entails and how to implement it in practical terms.* We see this as a key purpose for the Code. ESG has hit the mainstream, more and more investors are claiming adherence to responsible investment principles, and initiatives to rate the quality of responsible investment are emerging. We therefore have

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<sup>1</sup> ICGN (2015). ICGN Global Stewardship Code – Member Consultation.

<https://www.icgn.org/sites/default/files/ICGN%20Global%20Stewardship%20Code%20Consultation.pdf>

focused our comments below on defining the scope of the stewardship concept.

- *Serve as a point of reference to guide jurisdictions seeking to establish their own stewardship codes.* We see this as another important purpose of the Code.

A further possible application of the Code would be to serve as a briefing for other corporate stakeholders that are beginning to take an interest in the relationship between institutional investors and companies, to help disseminate understanding of the possibilities and limits of action by institutional investors in the pursuit of common objectives. These audiences would include beneficiaries, civil society and the general public. On occasion, and sometimes with the best intentions, campaigners have pressed investors to take action that could harm companies or damage the financial interests of beneficiaries and clients. They have done so, in some cases, when there were alternatives that were more consistent with fiduciary duty and potentially more effective in effecting change. In our experience, stakeholders can be disappointed at the cautiousness of investors because they lack understanding of our primary loyalty to beneficiaries and clients – not to mention the engagement tools at our disposal. It would also serve to bring new stakeholder voices into the debate about the emerging concept of stewardship. We would encourage ICGN to share the Code with leading civil society organizations that work on corporate sustainability issues.

2. *Do you believe the draft ICGN Global Stewardship Code is appropriately positioned to complement stewardship codes that are in place in other jurisdictions or to serve as a guide for the development of stewardship codes?*

The draft Code seems broadly consistent with local stewardship codes. The statement that domestic investors should first adhere to standards of stewardship in domestic codes could be clarified. Clearly, where the domestic code sets an equal or higher standard than the ICGN Code, the domestic code should take precedence. But domestic investors should not be discouraged from following, and should perhaps be encouraged to follow, a code that meets and exceeds the local standard.

3. *Do you agree with the seven principles of the Code? Is there a principle that should be excluded – or another principle that should be included?*

### **Preamble**

From our perspective, the framing of the concept of stewardship (outlined in the preamble, and further discussed in Section 2) is incomplete. We agree with the broad definition of “careful and responsible management of something entrusted to one’s care”, but the subsequent text focuses mainly on the relationship between the investment institution and the beneficiary. While this relationship lies at the core of stewardship, we believe there are additional considerations that could be combined for a more robust framing.

*Stakeholder theory of the firm:* For the past several years, including in earlier submissions to ICGN, we have been advancing the concept of the stakeholder theory of the firm. It is a widespread belief that the main purpose and obligation of a publicly-traded company 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 questionable. For example, 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*

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corporation.”<sup>2</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>3</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>4</sup>

The Code already acknowledges the responsibility of investment institutions to beneficiaries and clients whose money is managed. From the perspective of the stakeholder theory of the firm, the special influence institutional investors have over companies has potential consequences for the other stakeholders of the firm – and may generate further responsibilities.

**Systemic risk:** There is increasing acceptance of the position that fiduciaries can, and indeed must, take into account all factors that may be material to the performance of specific assets under their control – including environmental, social and governance (ESG) factors.<sup>5</sup> We welcome this evolution in the interpretation of fiduciary duty. However, focusing on the portfolio level is not sufficient to ensure the generation of the highest possible level of long-term sustainable value. Consideration must also be given to how investment decisions impact the global environmental, social and financial systems within which investment institutions operate. In this context, we draw attention to the recent inaugural report of the Investment Integration Project, and the current debate on this topic curated by Responsible Investor.<sup>6</sup>

**Responsibility to respect human rights:** As we have noted in earlier submissions, the 2011 UN Guiding Principles on Business and Human Rights<sup>7</sup> make it clear that the “responsibility to respect” human rights 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,

<sup>2</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>3</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>4</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)

<sup>5</sup> Over the past decade, as demonstrated by a series of major reports, the consensus on the relationship of ESG to fiduciary duty has shifted from confirmation that it is legal for investors to consider material ESG issues, to the assertion that it is a failure of fiduciary duty not to consider them.

- 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>
- PRI (2015). Fiduciary Duty in the 21<sup>st</sup> Century. <http://2xjmlj8428u1a2k5o34l1m71.wpengine.netdna-cdn.com/wp-content/uploads/Fiduciary-duty-21st-century.pdf>

<sup>6</sup> Steve Lydenberg (2015). Portfolios and Systemic Framework Integration: Towards a Theory and Practice. <http://www.investmentintegrationproject.com/resources-2/>

<sup>7</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>

*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 for 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).

For several years, we have been advancing the position that the “responsibility to respect” must logically extend to investment institutions.<sup>8</sup> Although the idea is not yet universally accepted in the industry, and the practical implications are still being worked out, in recent years it has been confirmed in international fora that the UN Guiding Principles and the OECD Guidelines for Multinational Enterprises have application for the financial sector just as they do for all other sectors, and specifically that they have application for minority shareholders.<sup>9</sup> We note that the OECD is conducting a process to develop guidance for responsible business conduct in the financial sector. Against this background, we believe ICGN should consider adding a specific reference to the need for human rights due diligence by investment institutions into relevant policy documents, including the Code. In the same way that it may fail to address systemic risk, integration of ESG to the traditional concept of fiduciary duty may not suffice to ensure that all investment institutions fulfill the “responsibility to respect”. 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 in respecting 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.

Reflecting these lines of thinking, we believe a robust framing of stewardship should be consistent with the stakeholder theory of the firm and simultaneously embrace the following outcomes:

<sup>8</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>9</sup> See, for example:

- OECD Responsible Business Conduct in the Financial Sector <http://mneguidelines.oecd.org/rbc-financial-sector.htm>.
- OECD Guidelines for Multinational Enterprises National Contact Point Norway (2015). Initial Assessment and Final Statement – United Steel Workers and Birlisik Metal IS vs. Norges Bank Investment Management [http://nettsteder.regjeringen.no/ansvarlignaringsliv-en/files/2015/06/Initial-Assessment-and-Final-Statement-02072015\\_.pdf](http://nettsteder.regjeringen.no/ansvarlignaringsliv-en/files/2015/06/Initial-Assessment-and-Final-Statement-02072015_.pdf)
- OECD National Contact Point Netherlands (2013). ABP/APG – SOMO/Both Ends. <http://www.oecdguidelines.nl/documents/publication/2015/1/6/final-statement-abp-apg---somo-bothends>

- Advancing the recent interpretations of fiduciary duty whereby investment institutions should consider material ESG factors that could impact the value of an investment, as well as short-term financial considerations. This concept is addressed currently under Principle 6 but merits more comprehensive integration to the Code.
- Consideration for system-level threats (e.g. the impact of climate change across portfolios, or market stability issues). This concept is addressed briefly in Section 2 as an aspect of stewardship but merits closer examination and earlier integration to the draft.
- Respect for absolute norms, even where they cannot be demonstrated to present a material risk to value (for example, the corporate responsibility to respect human rights; or prohibitions against weapons that infringe international humanitarian law). We see this as a basic requirement for all investors, not currently addressed in the draft Code. If applicable, clearly investment institutions should also comply with any further voluntary commitments about how investments will be managed (for example, a commitment not to invest in tobacco; or to consistently engage with fossil fuel companies).

To be clear, we consider that all three of the proposed stewardship outcomes should be pursued within a robust approach to stewardship.

In our view, the discussion in the preamble on the preconditions for effective stewardship in a given market raises questions that merit further consideration, and points to a possible gap in the development of investor networks.

For us, it has been a long-time subject of discussion whether to follow our global proxy voting guidelines in all markets, or consider local best practices in proxy voting where these practices are less stringent than our standard guidelines. By standing firm on global guidelines, an investor avoids encouraging companies to engage in “jurisdiction shopping” by listing in markets where there is less expectation of good governance. But at the same time the investor may fail to distinguish between the best and worst players in the local market. This may not be the ideal path to creating better governance outcomes if the desired behaviour would be highly unusual at the particular stage of development of that market. Further, where the investor has only limited holdings within a particular market, it may be unrealistic to expect a few companies in that market to take a locally-radical governance step. Generally in dialogue we try to explore what stage a company has reached, and push for incremental change.

Local networks for responsible investment have tended to group investors that are based in a market, but there has been less focus on creating networks of domestic and international investors that are highly exposed to specific local markets. Ideally, such market-focused networks might be led by domestic investors with comparative advantage in advancing change within that market, and capacity to focus on that activity, supported by international investors. We feel ICGN can play an important role in facilitating discussion on how to address the challenges of appropriate and effective stewardship in diverse markets.

### **Principle 1**

Principle 1 makes reference to the need to address “conflicts of interest”. In this context we note that the three stewardship outcomes we have outlined above may occasionally be in conflict, particularly in the short term. Where there is more than one possible course of action to address issues relating to the second and third outcomes, it goes without saying that a good steward should always choose the option believed to be most advantageous for beneficiaries and clients. However, we suggest it is the

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duty of all investment institutions to prioritize mitigation of system-level risk and respect for absolute norms over short-term value in situations where there is no alternative, and this should be considered entirely consistent with good stewardship.

#### **Principle 5**

We strongly agree with inclusion of engagement as a basic principle of stewardship. We note that some of the emerging initiatives to rate the quality of responsible investment have ignored or overlooked this vital opportunity for investors to contribute to positive change at companies. Page | 6

#### **Principle 6**

We question whether confining discussion of material ESG factors to a separate principle weakens the positioning of this important consideration. We would prefer to see consideration of material ESG factors integrated to the fundamental definition of the concept of stewardship in the preamble, and then addressed in each section of the guidance notes. This mainstreams ESG as fundamental to stewardship.

The Code promotes a long-term perspective, but also refers to safeguarding the interest of clients and beneficiaries over the time horizon matching that of the clients and beneficiaries. It does not address the implications for stewardship practice if, for legitimate reasons, that time horizon is relatively short. The question of how to undertake stewardship in the context of investments with shorter time horizons is rarely explored and merits further discussion.

#### **Additional Principles**

We suggest the following as possible additional principles:

- *Being well-informed.* We believe that in all aspects of stewardship activity, there should be a commitment to being well-informed. Potentially this could be integrated to a revised version of Principle 1, covering the full scope of what is required in order to be well-organized to undertake stewardship, in terms of governance structures, policy, capacity and resources. Governance arrangements are important, but it is also important that adequate resources should be devoted to stewardship activities. A robust understanding of ESG risks should form part of being “well-informed”.
- *Engaging on public policy and standards.* We believe good stewards have a responsibility to address sector-wide and systemic risk both in relation to investee companies and the investment industry within which we all work. In its *Statement of Principles on Institutional Investor Responsibilities*<sup>10</sup> (p7) and its *Global Governance Principles*<sup>11</sup> (p24), ICGN has already advanced the concept that institutional investors should engage in the development of relevant public policy and good practice standards, and this idea should also be integrated to the Code. For a decade, NEI has had an active and successful program of public policy engagement on a wide range of issues material to our investment practice, and in our experience the participation of investors in consultations and multi-stakeholder initiatives is highly valued. Just as we ask our investee companies to be transparent on their lobbying, if investors participate in public policy debate and formulation, this should be disclosed. For example, we publish our

<sup>10</sup> ICGN (2013). Statement of Principles on Institutional Investor Responsibilities

[https://www.icgn.org/sites/default/files/ICGN%20Institutional%20Investor%20Responsibilities\\_0.pdf](https://www.icgn.org/sites/default/files/ICGN%20Institutional%20Investor%20Responsibilities_0.pdf)

<sup>11</sup> ICGN (2014). Global Governance Principles. [https://www.icgn.org/file/1303/download?token=79S4L\\_6C](https://www.icgn.org/file/1303/download?token=79S4L_6C)

submissions on our website.<sup>12</sup>

4. *Are there aspects of the guidance points that you do not agree with or are there further guidance points to consider?*

**Principle 2 guidance**

We suggest that stewardship policies should highlight not only stewardship codes that the institution follows, but any other standards or commitments that are followed and which could impact investment decision-making (for example, a commitment to the UN Guiding Principles, the OECD Guidelines on Multinational Enterprises or the Global Compact).

**Principle 4 guidance**

We agree that investors should be prepared to vote against management resolutions if they are inconsistent with good business or governance practice, with the understanding that this also encompasses a duty to vote against if that is demanded by other commitments that the investor may have made. We strongly agree that investment institutions should publish voting policy and actual vote records. 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 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. We agree that ideally investors would provide feedback before the annual meeting, but the reality of condensed proxy seasons in many markets makes that challenging.

**Principle 5 guidance**

It is stated that investors should engage on “material factors” and “with the aim of preserving or enhancing value on behalf of beneficiaries or clients”. We believe this is too restrictive: although this will usually be the motivation, an investor could on occasion be driven to engage on an issue that is not immediately material through adherence to absolute norms (such as the responsibility to respect human rights) or because of an ethical commitment to beneficiaries.

The code is largely silent on ethics within the corporate engagement process. However, it does mention establishing policies for the engagement process. It is not clear to whom these policies should be disclosed. In this context, we note that NEI Investments has a code of conduct for engaging external parties, covering relations with stakeholders including companies and communities affected by the issues on which we engage.

**Principle 7 guidance**

It would be helpful to pull together in one place the list of disclosures that would be required to demonstrate adherence to the Code, whether these disclosures are required or desirable, whether they must be public or can be restricted to clients and beneficiaries, and the rationale for these obligations to different audiences. We outline below disclosures we identified in the draft:

<sup>12</sup> NEI Investments – Public Policy & Standards. <https://www.neiinvestments.com/pages/about-nei/about-ethical-funds/esg-difference/public-policy-and-standards/>

- Principle 1:
  - “statement of adherence to the Global Stewardship Code” including disclosure of conflicts of interest (audience not defined)
  - disclosure on remuneration structures and performance horizons (disclosed to beneficiaries and clients)
- Principle 2:
  - policy framework (publicly disclosed)
  - “statement of commitment to principles of the ICGN Global Code” (published on the website)
- Principle 4
  - Disclosure of voting policies (audience not defined)
  - Disclosure of actual voting records (publicly disclosed)
  - Inclusion of voting activity in reporting to clients and beneficiaries
  - Disclosure of extent of use of proxy research and voting services, identity of provider, and degree to which recommendations are followed (audience not defined)
  - Disclosure of approach to stock lending (audience not defined)
- Principle 7
  - Records of client meetings, voting and engagement (audience not defined, presumably internal)
  - Summaries of stewardship activities (audience not defined)
  - Major stewardship priorities and forward-looking engagement strategy (encouraged to disclose – audience not defined)
  - Voting activity (publicly disclosed)

5. *Are there aspects of the roles of asset owners, asset managers and companies that you do not agree with or are there further guidance points to consider?*

As noted earlier, there are other stakeholders to investor stewardship, including beneficiaries and clients, civil society organizations that may critique or engage with companies and their investors, and the wider public that may be materially affected by the actions of companies or investment decisions. For completeness, these stakeholders could be identified in Code.

## Conclusion

In conclusion, we thank ICGN for developing the draft Code and seeking comments from members. We reiterate the following recommendations:

- Reviewing the Code draft through the lens of the stakeholder theory of the firm and expanding the scope of the definition of stewardship to embrace integration of material ESG risks at the portfolio level, consideration of systemic risks, and respect for absolute values.
- Adding principles on “being well-informed” and “engaging on public policy and standards”.
- Clarifying the list of disclosures required to demonstrate adherence to the Code.
- Considering the potential application of the Code to educate additional stakeholders on investor responsibilities.
- Considering the implications of a possible gap in investor networking regarding tailored approaches to advancing governance in specific local markets to which both domestic and international investors are exposed.

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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**

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Robert Walker  
Vice President, ESG Services

CC:

Board of Directors, NEI Investments

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