Responsible Business Conduct for Institutional Investors
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With approximately $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 over the shareholders.

The following pages outline our perspective on the paper *Responsible Business Conduct for Institutional Investors – Draft for Discussion*, which was published for comment in February 2016.

Background on the OECD Guidelines and "Responsible Business Conduct"

Adopted in 1976, the OECD Guidelines for Multinational Enterprises (the Guidelines) are a comprehensive set of recommendations on corporate responsibility backed by over 40 countries, including Canada. The Guidelines cover many aspects of responsible business conduct, including employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation. Adhering governments must set up a National Contact Point (NCP), which is intended to act as a grievance mechanism where companies are alleged to have breached the Guidelines.

The Guidelines were last updated in 2011, taking into account the adoption of the UN Guiding Principles on Business and Human Rights (the UNGPs). According to the UNGPs, all companies have the "responsibility to respect" human rights, and a human rights due diligence approach is promoted.

For over five years we have been exploring the implications of the Guidelines and UNGPs for responsible investment processes, particularly with respect to human rights. Our focus on this issue is borne out by the fact that in the period 2011-15, 17% of instances raised with NCPs related to the financial sector, compared with only 8% in the period 2000-10.[1]

The OECD is now undertaking a multi-stakeholder process to develop guidance on due diligence approaches for application of the Guidelines in the financial sector. In the following pages we share the feedback that we provided to the OECD on the February 2016 paper, which was published as part of this process.

Defining "Responsible Business Conduct" for institutional investors

In a recent submission to the International Corporate Governance Network (ICGN) on its draft Global Stewardship Principles, we articulated the following ideas in combination as representing "responsibility" within the investor stewardship context:

- Advancing recent interpretations of fiduciary duty whereby investment institutions should consider material ESG factors that could impact the value of an investment, as well as financial considerations.
- Consideration for system-level threats (e.g. the impact of climate change across portfolios, or market stability issues).

[1] OECD (2015). Implementing the OECD Guidelines for Multinational Enterprises: the National Contact Points from 2000 to 2015.

- Respect for absolute norms, even where they cannot be demonstrated to present an immediate material risk to value (for example, the corporate responsibility to respect human rights and other norms promoted in the OECD Guidelines; or prohibitions against weapons that infringe international humanitarian law).
- Additionally, and as applicable: any further voluntary commitments about how investments will be managed (for example, a commitment not to invest in tobacco; or to engage consistently with fossil fuel companies).

From our perspective, guidance on responsible business conduct for institutional investors should take into account the following point:

- "ESG risk" is understood by many investors to mean environmental, social or governance factors that present a risk to the value of an investment: in other words, adverse impact for the investor, with the underlying focus on financial outcomes. This concept of "fiduciary ESG" is different from the focus of the Guidelines on adverse impacts to rights-holders.
- We strongly endorse the position that engagement should be prioritised and divestment seen as a last resort. This should be explained in more detail, focusing on the ultimate goal, which should be that adverse impacts are prevented or mitigated.
- We point to the engagement of NEI Investments and its partners on the Goldcorp Marlin mine human rights assessment as a case study for testing the due diligence approach discussed in the paper. Would the investors involved have behaved differently if they had been following this approach, and how would that have affected the outcome for the company and rights holders?
- Lack of ESG resources cannot be considered a legitimate reason for failing to undertake OECD due diligence. Collaboration and pooling of ESG resources to increase impact is certainly to be encouraged, but free-riding on the efforts of other investment institutions without contributing to the sum of ESG resources is not.
- There is a need to raise basic awareness in the investment community of the OECD Guidelines and UNGPs, as a prerequisite for understanding their application to investors.

Detailed comments on the paper

Note: numbering refers to sections and paragraphs in the draft.

Section 1 - Introduction

1) As well as providing guidance for investors themselves, a further possible application of a guidance document on responsible business conduct for investors 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, helping 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. A guidance document could also serve to bring new stakeholder voices into the debate about the emerging concept of investor stewardship.

4) Although we have no issue with the decision to begin this exploration by focusing on responsibilities relating to human rights, workers' rights and the environment, OECD should be aware of emerging investor interest in other issues covered by the Guidelines, including taxation and anti-corruption – both of which form the topic of current PRI collaborations.

Section 2 - Terminology

9) We believe it is critical to resolve the issue of the use of the same terminology to convey different meanings in such a way that there is no confusion for investors, especially given current relatively low levels of investor awareness of the OECD Guidelines. In general, the "glossary" table in the paper explains well some important differences in the way that the OECD and institutional investors use the words "risk", "due diligence" and "leverage". However, we feel that there is potential for confusion if "ESG" is used as the qualifier to distinguish ideas and activities relevant to the Guidelines from our usual investment terms of art. This is important as the purpose of this project is to educate investors on a set of responsibilities that are, in our experience, not yet generally understood or accepted within our industry.

Specifically, many investors would interpret "ESG risk" as referring to environmental, social or governance factors that present a risk to the value of an investment: in other words, adverse impact for the investor, with the underlying focus on financial outcomes. This concept of "fiduciary ESG" is quite different from the focus of the Guidelines, which is on adverse impacts to rights-holders.

Since the UN Guiding Principles on Business and Human Rights (UNGPs) were published in 2011, we have been expressing the view in submissions to the UN, financial industry associations and government that if there is an absolute responsibility for all companies to respect human rights, it must surely apply to our own community of financial companies.[2] But in our experience of raising this question within the investment community, awareness of (let alone agreement with) this possibility is not universal. On a number of occasions, peers within investor collaborations have asked for a financial risk business case (in other words, a case based on "fiduciary ESG") to be made for investor action on matters that could represent severe ongoing adverse impacts to rights-holders. The existence of a financial risk business case obviously adds weight to concerns surrounding an adverse impact, but according to the paper, and our own reading of the Guidelines and UNGPs, investors would have a responsibility to take action even if the adverse impact does not harm their financial position.

Given the above, we believe that at this stage it would be highly advisable to use something other than "ESG" as the qualifier in the document – choosing instead a unique qualifier that could be placed in front of "risk", "due diligence" and "leverage" in this context to distance them from the usual investor terms of art. We suggest using "OECD", "OECD Guidelines" or "RBC" as the qualifier in front of the disputed words (while noting that here in Canada, the acronym "RBC" could cause confusion as it is the commonly-used acronym for our largest bank, the Royal Bank of Canada).

Section 3 – Relationship of the Guidelines to institutional investors

14) One way of looking at the question of whether the investor-investee relationship constitutes a "business relationship" that could generate responsibilities under the Guidelines might be to look at it from the perspective of the investee. Many publicly-traded companies reference shareholders in

[2] We have raised this issue on numerous occasions in policy consultations, including written submissions to the UN Working Group on Human Rights and Transnational Corporations and Other Business Enterprises (in 2011 and 2012); the Office of the United Nations High Commissioner for Human Rights (2012); and the International Corporate Governance Network (2014 and 2016).

talking about the purpose of the corporation, sometimes among other stakeholders. Indeed, some issuers frame their purpose primarily or solely in terms of delivering shareholder returns. If the company believes it exists to serve investors, it is difficult to say that there is no business relationship.

15) To say that institutional investors "may therefore be considered to have" a business relationship could be construed by some as saying that it is up to us to decide if we believe this or not. We are a compliance-driven community. To avoid confusion, stimulate action and create a level playing field, a clear statement is needed as to whether or not the Guidelines can apply to institutional investors. We have long accepted that logically, this must be the case. But discussions with other investors suggest that this is not obvious to everyone in our community.

16) The paper notes that PRI signatories commit to be active owners and to incorporate ESG to their practices, while some investors also reference the UN Global Compact and the OECD Guidelines. This point merits further clarification: at present these represent two different concepts of investor responsibility, one which might be described as "fiduciary ESG" focused on impact on investment returns, the other being "norms-based". Some investors combine the two in their approach to responsible investment, but from our perspective they remain distinct concepts.

Section 5 - Investor relationships to adverse impacts and expectations under the Guidelines

24) 26) 28) The examples of relationships that linkage to adverse impacts, all of which are helpful, are extremely important given the current relatively low level of awareness of the Guidelines in the investment community. More detailed examples and case studies might be desirable to help build investor understanding.

27) Although the "investment chain" is mentioned in this section, it may be helpful to clarify that both an asset owner, and an asset manager hired by the asset owner, may be in a chain that is directly linked to an adverse impact. The division of responsibility between the asset owner and the asset manager in this situation may merit more detailed discussion. It may also be helpful to build out the diagram in this section to illustrate the possibility of several more links in the chain, for example:

Asset Owner < business relationship > **Asset Manager** < business relationship> **Investee Company** <business relationship> **Supply Chain Company** > causal action/omission > **Adverse Impact**

29) An additional diagram to illustrate an example of a relationship creating "no direct linkage" to an adverse impact might also be helpful.

30) Does the conclusion that there is "no direct linkage" to an adverse impact also apply in the case of the shareholders of one publicly-traded company, if there is an adverse impact associated with another publicly-traded company within the same group of companies? The Power group of companies provides an example that may be useful for considering this question. Power Corporation, Power Financial and Great-West Lifeco are all publicly-traded companies. Reviewing the organization chart, it seems obvious that the shareholders of Great-West Lifeco (majority owned by Power Financial) would be directly linked to an adverse impact caused by London Life (100% owned by Great-West Life), and would not be directly linked to an adverse impact caused by Total (a minority stake of which is included in a separate investment chain linking back to Power Financial). But what would be the relationship of the shareholders of Power Corporation or Power Financial to an adverse impact created by Total?[3]

[3] We do not raise the Power group as an example because of current, specific concerns about impacts on rights holders, but merely because its structure provides a useful illustration for a particular type of linkage situation. Indeed, recently the group

32) The first sentence in this section is confusing: for clarity, here we are trying to distinguish whether the investor (not the investee) is "contributing" or "directly linked" to the adverse impact.

36) It is concluded in this section that a minority shareholder relationship is unlikely to result in a "contributing" relationship.

As a concrete test of this conclusion, how should we categorize Investor B's action in the following example? Investor A and Investor B are minority shareholders in an investee company that has caused, or is at risk of causing, an adverse impact – therefore, both investors are "directly linked" to the adverse impact. Investor A files a well-constructed shareholder proposal at the investee company, asking it to take an appropriate action under the Guidelines to address the adverse impact. Investor B votes against the shareholder proposal. By this action, has Investor B incentivised the investee company to cause or continue to cause the adverse impact, and therefore moved from "directly linked" to "contributing"? (In this context, we note that the call-out box at para 72 states that there may be a due diligence expectation for stock exchanges. Would the same expectation apply to the proxy advisors who give guidance to investors on how to vote shareholder proposals relating to adverse impacts on rights holders?)

Our involvement with the Goldcorp Marlin Mine human rights assessment project may be a useful practical case study for analysing the status of minority shareholders. In this case, after filing a shareholder proposal that contributed to the decision to undertake a human rights assessment, we were one of several investors that took a role in the steering committee for the assessment. There was little precedent for this type of initiative at the time, and little guidance on the implications for investors of taking such an active role. We were both strongly criticized and praised at the time – with some of that criticism turning to praise later. Five years on, the Marlin assessment still stands as a leading edge example of transparency in corporate human rights assessment. It would be interesting to explore whether the active shareholder role that we and our partners took in the effort to find a solution to the problems at Marlin would, based on the guidance in this paper, be deemed either highly appropriate as a strong action to prevent or mitigate adverse impacts; or highly risky in that the level of influence exerted by the investor might be considered to change the relationship to an adverse impact from "directly linked" to "contributing" (with the accompanying requirement to remediate).

Section 6 – Due Diligence approaches for institutional investors

43) Once again, for investors unfamiliar with the OECD Guidelines, considerable awareness-raising may be required to enable good understanding of the types of adverse impacts that should be considered within a due diligence framework, and how they can be assessed for severity. Some examples would be helpful in this context.

45) 46) These paragraphs address the important point that while there may be an alignment between OECD due diligence and what we have called "fiduciary ESG" (focused on risk to the investor's return), the primary consideration for OECD due diligence is severity and likelihood of adverse impact for rights holders. It is vital that investors should understand that in the OECD Guidelines context, pursuing "fiduciary ESG" may not be enough - although sometimes it will be enough. As noted earlier, to avoid confusion and help investors to separate the two ideas, at present it would be preferable to restrict the

has enhanced its efforts to explain how corporate responsibility is addressed through its holdings. However, we note that ten years ago as shareholders of Power Corporation we undertook engagement with the company because of human rights concerns within its extended investment chain.

use of the term “ESG” to refer to the “fiduciary ESG” context, and to use different terminology for the OECD Guidelines context.

Section 7 – Establishing Strong Management Systems

51) In this section on the types of management systems that could be relevant for implementation of the OECD Guidelines, once again it would be helpful to define more clearly what is meant by the various references to “ESG”. Many investors who have already established systems to conduct “fiduciary ESG” might need to make adjustments to those systems in order to integrate OECD due diligence.

The “procedures” bullet point should make reference to engagement (including proxy voting and dialogue with companies). The separate bullet points on “allocation of responsibility” and “internal governance” seem potentially duplicative, and the latter is somewhat unclear.

53) In the rare cases where domestic laws and regulations might conflict with OECD due diligence, is there an obligation on investors to raise this in the public policy context?

54) – 58) Although OECD due diligence on adverse impacts and “fiduciary ESG” focusing on risks to the investor will often align, we know from experience that sometimes they do not. There have been instances where we have felt obliged to exclude or divest from an investee that would have added value to our portfolios, at least in the short term, because the investee was unwilling to address an issue that we believed would constitute a severe adverse impact under the OECD Guidelines (and could not be persuaded to another course of action through engagement). This section would benefit from greater clarity on the possible implications of restricting OECD due diligence only to situations that align with risk to the investor. Can an investment institution plausibly claim to be complying with the OECD Guidelines if it does not undertake due diligence activities in relation to an adverse impact on a rights holder unless it is exposed to negative financial consequences itself?

Section 8 – Identifying actual and potential adverse impacts

63) It is assumed here that the only option for an asset owner is to task and monitor the external manager to conduct due diligence. This is not the only option. Although our funds are externally managed, we choose to undertake our own evaluation and monitoring of companies for adverse impacts. The key point is that the asset owner should make efforts to this activity takes place, whether internally or externally.

67) This paragraph could be misinterpreted as suggesting that investors with large portfolios have less responsibility to identify specific instances of adverse impact. To draw an analogy from the supply chain management context, few would make the argument that a consumer brand is less obliged to be aware of supply chain conditions because it has many suppliers. We also note that in recent years some prominent investors have chosen to reduce the number of their holdings in order to conduct better monitoring of those holdings. It seems reasonable that all investors should be expected to have a process, be able to demonstrate that the process is being applied, and that reasonable resources are devoted to the process. It is hard to see how an investor that is unwilling to devote any internal or external resources to due diligence could claim to be following with OECD Guidelines.

71) The idea of providing a mechanism through which anyone can contact an investor to make known a possible adverse impact situation is interesting. A case study of such a mechanism would be valuable.

72) As a participant in the Sustainable Stock Exchanges investor working group, we have taken note of the reference to the possible responsibility of exchanges within the OECD Guidelines context.

Section 9 - Preventing and mitigating adverse impacts

76) In the discussion of ways to influence investees causing adverse impacts, the second bullet point under "exclusion or divestment" seems to imply that before divesting based on a company's business conduct, an investor should try to engage. We would strongly agree with this approach, but in our experience investors may come under pressure to divest immediately, particularly from some civil society organizations. Therefore, the rationale for trying to engage before divesting should be explored and explained in more detail. For us, divestment is never an end in itself. The ultimate goal of the OECD Guidelines – and of our engagement - is to reduce the incidence of adverse impacts. By attempting engagement, an investor may be able to influence the company to address an adverse impact. Once a minority investor has divested, it loses much of its leverage with the company – and it may be replaced by an investor with less interest in upholding the OECD Guidelines. (However, we will divest immediately if that is deemed to be in the best financial interest of the funds, even if we have some hope of influencing the company's behaviour through engagement.)

The last bullet point in this section – participation in industry initiatives such as PRI – should not on its own be considered adequate as a means to prevent and mitigate adverse impacts. There is a considerable level of free-riding in many responsible investment initiatives, and it is possible to "participate" (i.e. sign up) while taking minimal or no action with respect to investment processes or actual adverse impacts. In our view this bullet point should be qualified, deleted or integrated to the engagement bullet point: in fact there is already a reference under the engagement bullet point to collaboration with other investors.

81) An important point is made here that could be further emphasized. The fact that an individual minority shareholder may not have a great deal of leverage does not mean that the investor should not make an attempt to address the adverse impact. Companies constantly tell us that if more shareholders asked them to address particular ESG issues, it would be extremely helpful for the prioritisation of action on those issues.

82) Even investors that are not considered "large" in absolute terms can build disproportionate influence by virtue of their reputation. In our experience over the past fifteen years, we have been able to encourage change at companies where our holding was a very small fraction of one percent, because we are the biggest name in the retail responsible investment market in Canada, and we have brought good arguments to the company. We also point to the example of some of the U.S. religious orders that engage through the ICCR collaboration: their holdings are usually much smaller than our own, but they have earned the respect of U.S. mega-cap companies through years of engagement. Companies are generally open to discussion with institutions that they find to be trustworthy and a reliable source of useful ideas.

87) Once again, we agree with the position in the paper that divestment is the last resort, but it may be helpful to spell out more clearly in the paper why that is the case (see comments on para 76) above for some of our arguments).

90) Under the first bullet point on "meaningful influence", the company's will to mitigate the impacts is mentioned. This seems a highly legitimate criterion for deciding to choose engagement over divestment, but less legitimate as a criterion for an investor to decide whether or not to prioritize that investment for prevention and mitigation activities in general. Given two investee companies

associated with actual severe adverse impacts, an investor might choose to deal first with the company that appears most willing – and this might indeed be helpful, if it creates a positive example for the second company. But not to deal with the second company at all while continuing to hold the investment seems to us an inadequate response.

The third bullet point on "resource implications" should be qualified - otherwise it could be used as an excuse not to take action on any adverse impacts associated with the investor's portfolio. If an investor does not have sufficient resources to deal with an issue affecting one investment because its ESG resources are tied up dealing with another issue of equal or greater severity affecting another investment, "resource implications" could be a legitimate reason for temporary inaction. But it is hard to see how an investor that is unwilling to devote any internal or external resources to due diligence could claim to be following with OECD Guidelines.

92) In general, the paper sets out a good list of topics to include in public reporting. We would once again recommend coordination with the ICGN Global Stewardship Principles, which includes a similar list of suggested disclosures. Voting guidelines, as well as voting disclosure, could be added to the list. We note there are some constraints on the ability of active investors in competitive markets (such as the retail fund market in which we operate) to disclose up-to-date holdings publicly. What might constitute reasonable openness for investors in these situations may merit further discussion.

93) We are aware that some investors are concerned about disclosing on engagement, but note that for fifteen years we have been disclosing the companies that we meet with and the ESG topics that we raise, while respecting confidentiality regarding what we hear from the companies. Examples of this disclosure can be found here. This level of disclosure has never been an issue for the companies that we engage in dialogue.

94) Given the above point, investors claiming the need to ensure confidentiality should certainly be expected to justify their position.

105) It might be useful to once again reiterate at the end of the paper that when an investor chooses not to assign any resources to creating the capacity to deal with adverse impacts, it surely cannot claim to be undertaking effective OECD due diligence, and opens itself to the risk of challenge on this.

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