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Corporate Profile

Established in 1989, the Social Investment Organization is a national non-profit organization dedicated to the advancement of socially responsible investment in Canada. It is funded primarily from membership dues and is accountable to its membership. The SIO has more than 400 members across Canada, representing the following:

- Socially- and environmentally-screened mutual funds and their staff
- Financial institutions providing socially responsible investment products or operating according to corporate social responsibility principles
- Investment advisors providing advice and assistance on socially responsible investment
- Investment managers managing socially responsible investment assets
- Institutions investing according to socially responsible investment guidelines
- Retail investors investing according to socially responsible investment guidelines
- Non-governmental organizations and other groups with an interest in responsible investment

Our members manage serve more than half a million depositors and investors in Canada.

The mandate of the SIO is to raise the public profile of socially responsible investment, to reach out to other groups interested in socially responsible investment, to provide information to our members and the public and to take a leadership role in coordinating the development of the socially responsible investment agenda in Canada.

Socially responsible investment is defined as the process of selecting or managing investments according to social or environmental criteria. We estimate there is approximately \$50 billion in socially responsible investment assets in Canada.

Socially responsible investment includes three components:

1. Positive and negative screening. This is the application of social and environmental guidelines or "screens" to the investment process. Negative screens usually include issues such as tobacco and military production, companies operating with sweatshop or child labour, or the manufacture of alcohol or pornography. Examples of positive screens are companies making a

contribution to social, economic or environmental sustainability or industries with exemplary employee practices.

2. **Community Investment.** This is the investment of money in community development or micro-enterprise initiatives that contribute to the growth and well-being of particular communities. The idea is to reverse the drain of capital and income that debilitate low-income communities.
3. **Shareholder Advocacy.** This is the process of using shareholder influence to help to bring about positive social and environmental change at corporations. This can include corporate engagement (communicating with management on particular issues), filing shareholder resolutions and using the threat of divestment to bring about positive change.

SIO members believe that socially responsible investment represents a catalyst for positive social change as well as a useful investment tool to enhance returns and reduce risk by incorporating social and environmental factors traditionally excluded from portfolio management.



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December 18, 2002

David Brown
Chair
Ontario Securities Commission
20 Queen St. West, 19th floor Box 55
Toronto ON M5H 3S8

Dear Mr. Brown:

Re: National Instrument 81-106 and mutual fund proxy voting

I am writing to you today on behalf of the Social Investment Organization on the issue of mandatory disclosure of proxy voting policies and votes cast by mutual funds.

The Social Investment Organization -- representing the socially responsible investment industry in Canada -- believes that proxy voting represents an important asset. As such, mutual funds should be encouraged to develop policies to determine how they vote their proxies. Moreover, since mutual funds vote their shares on behalf of their unitholders, unitholders have a right to know how mutual funds cast these votes.

We are writing to you from our experience as the trade association for the socially responsible investment industry in Canada. Our members represent socially screened mutual funds, as well as financial institutions, asset management firms and financial advisors with socially responsible investment mandates. Our members serve more than half a million depositors and investors in Canada. I have enclosed a corporate profile with this letter.

Our members have been in the forefront of this issue. Ethical Funds Inc. -- one of our sustaining members -- was the first mutual fund company in Canada to disclose its proxy voting policies, and how it votes on shareholder proposals. Other socially responsible investment funds have followed this practice. We believe it is an issue of fundamental transparency that investors know how their assets are being voted on critical issues of corporate governance and social responsibility.

Investors across Canada are watching with great interest as governments and securities regulators in the United States take necessary steps to improve corporate governance, address accounting scandals, and restore confidence in the markets.

Most recently, on Sept. 19, 2002, the board of the Securities and Exchange Commission (SEC) voted unanimously in support of proposals that will require all US mutual fund companies and investment advisors to disclose proxy votes and voting policies. The deadline for comment on the proposed rules was Dec. 6.

Specifically, the SEC proposals call for mutual fund companies to:

- Disclose the policies and procedures used to determine how to vote proxies relating to portfolio securities;
- File complete voting records with the SEC including information identifying the matter voted on; whether the matter was proposed by the issuer or by a security holder; whether and how the fund cast its vote, and whether the fund cast its vote for or against management;
- Disclose proxy votes that are inconsistent with stated proxy voting policies;
- Disclose proxy voting policies and voting record to unitholders.

There was significant support for the proposal, and we trust that the SEC will approve the new rules.

Proxy voting is an important, but often overlooked, investor responsibility. It is a crucial mechanism for making mutual fund managers accountable to unitholders — the owners of mutual fund assets. Proxy voting disclosure would help ensure that mutual funds support corporate governance policies and practices that are in the best interests of unitholders, rather than company managers. It is unlikely that many of the corporate governance practices now coming to light would have been tolerated by investors had these been more widely known and recognized as detrimental to the long term health of the corporation. Enhanced proxy voting disclosure could help prevent future financial disasters. Our members believe every investment company has an obligation to report publicly how it votes the shares held on behalf of investors.

In citing reasons for its proposed new rules, the SEC states that conflicts of interest may occur when mutual funds manage or seek to manage corporate retirement savings plans. “In these situations,” states the SEC, “a fund’s adviser may have an incentive to support management recommendations to further its business interests.” While we have no way of knowing how widespread this practice may be, the SEC’s suggestion leaves open the possibility of conflict-of-interest, even if its rarely happens. The only way that investors can be assured that mutual funds are voting their shares in the interests of unitholders is if proxy voting policies are made public, and the results of shareholder votes are disclosed.

National Instrument 81-106

In Canada, the Ontario Securities Commission has indicated some interest in this issue, but the only proposed rule in this area (cited in the requirements for Form 81-106F1 in the proposed new National Instrument 81-106) is wholly inadequate to achieve meaningful reform in this area. As you know, National Instrument 81-106 is being circulated for comment by the Canadian Securities Administrators (CSA) until Dec. 19.

The provision for mutual fund proxy voting disclosure is contained in Part B of the proposed new National Instrument, which sets out the requirements for the proposed annual Management Discussion of Fund Performance (MDFP) Report. In Section (h), the proposed rule states that the annual MDFP will include a discussion of “how the portfolio advisers or the manager of the investment fund voted on matters relating to issuers of portfolio assets of the investment fund, other than routine business of those issuers.”

While this rule appears to require mandatory disclosure of voting, the fact that it appears in the annual MDFP means that any discussion by the mutual fund of its voting record would have to be brief and very general. The guidance provided in the proposed rule is that annual MDFPs be about four pages in length. The discussion on voting would be one item among many, including portfolio changes, material changes in investments, unusual sales changes, operational changes, risk factors, related party transactions, and other material changes. Needless to say, such a discussion would treat voting in a perfunctory and cursory manner. Mutual funds would not be required to provide details of votes on a company-by-company basis, and therefore investors would not have adequate information to determine whether votes are being cast appropriately.

Recommendation

Therefore, we recommend that the OSC and the CSA eliminate Section h, Part B in Form 81-106F1. Instead, we strongly urge the OSC and the CSA to study the new proposed SEC rules on voting disclosure by mutual funds and to introduce new rules that would do the following:

- Require all Canadian mutual funds to disclose the policies and procedures used to determine how they vote proxies relating to portfolio securities;
- Require all Canadian mutual funds to disclose on their websites each shareholder proposal voted on; who proposed the shareholder resolution; whether and how the fund cast its vote, and whether the fund cast its vote for or against management.

Further, we recommend that these new rules be incorporated into a new proposed National Instrument for adoption by OSC and CSA members across Canada, and that this new National Instrument be circulated for comment in 2003.

We believe that the costs of implementing this system would not be significant. Funds may entail some minor costs related to reporting their proxy votes but they would not be substantial, given that we recommend the reporting be done through fund websites. There may be some other costs related to proxy advisory services, but this must be seen as a necessary cost of doing business given that proxy voting is a fiduciary duty of mutual fund companies.

The SIO believes that voting disclosure ultimately should include all major asset management firms, as well as mutual funds and pension funds. However, given the fact that the OSC and CSA are currently reviewing continuous disclosure requirements related to mutual funds, we recommend that regulators begin with the mutual fund industry as the starting point for enhanced investor transparency on this issue.

We believe that securities regulators have a responsibility to establish meaningful reforms that will restore investor confidence in the capital markets. With the current crisis of confidence in the securities industry as a result of corporate scandals, securities regulators have an obligation to create a regulatory system that increases investor transparency and institutional responsibility. Mutual fund managers have a fiduciary duty to vote their shares on behalf of the investors who own units in their funds. As a result, investors have a right to know how mutual funds vote their property on issues of corporate governance and social responsibility.

Sincerely,

Hard copy by mail

Eugene Ellmen
Executive Director

CC John Stevenson, Secretary
Ontario Securities Commission
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On behalf of the Canadian Securities Administrators

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities Commission
Manitoba Securities Commission
Ontario Securities Commission
Securities Administration Branch, New Brunswick
Office of the Attorney General, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Department of Justice, Government of the Northwest Territories
Registrar of Securities, Government of Yukon
Registrar of Securities, Legal Registries Division, Department of Justice, Government of Nunavut

And

Denise Brosseau, Secretary
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