Canadian Coalition for GOOD GOVERNANCE

THE VOICE OF THE SHAREHOLDER

May 15, 2014

Ms. Kerrie Waring
Managing Director
International Corporate Governance Network

Dear Ms. Waring,

Re: ICGN Member Consultation
Draft ICGN Global Governance Principles
March 28, 2014

We have reviewed the proposed ICGN Member Consultation on the Draft ICGN Global Governance Principles (the "Principles") released in March 2014 and we thank the ICGN for the opportunity to provide you with our comments.

Representing the interests of Canadian institutional shareholders, CCGG promotes good governance practices in Canadian public companies and the improvement of the regulatory environment to best align the interests of boards and management with those of their shareholders and to promote the efficiency and effectiveness of the Canadian capital markets. Our members collectively manage over $2 trillion of savings on behalf of most Canadians.[1]

Overview

We support updating the Principles and producing a single set of Principles to set out the governance roles and responsibilities of board directors and shareholders in one document.

We provide our specific comments below.

Preamble

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?

While the Principles are intended to be on a 'comply or explain' basis, it is not clear where a shareholder would explain any divergence from the Principles.

[1] A list of our members can be found at http://www.ccgg.ca/index.cfm?pagepath=About_CCGG/Membership&id=17577

We suggest a clearer statement in the Preamble to the effect that the application of the Principles might vary depending on whether the institutional shareholder is an asset owner or asset manager.

Similarly, we also suggest that there be recognition in the Preamble that while the stewardship responsibilities of institutional shareholders do not vary depending on the nature of the investment (for example, active management vs. passive holdings), the spectrum of shareholder engagement which is appropriate may vary and can range from proxy voting to the exercise of governance rights (such as seeking board representation) depending on various factors, such as the size of the holdings.

Section 1: Boards

Do you have any comments with regards to the drafting of the principles in 'Section 1: Boards' and are there any other recommendations you believe that the ICGN should include?

We have the following comments on **Section A: Board:**

1. Section 1.1 – CCGG recommends that the phrase "long term" be added before "interests of the company" so that the sentence reads: "Board members should act on an informed basis and in the best long term interests of the company with good faith, care and diligence, for the benefit of shareholders, while having regard for relevant key stakeholders."

2. Section 2.5 – CCGG's supports the view that boards should be comprised of a "majority of independent directors". This is a best practice to which companies in all jurisdictions should aspire. However, CCGG recognizes that practice may legitimately vary from this standard in the case of controlled companies.[2]

3. Section 2.7– Given the importance of *in camera* sessions for the ability of the board to function independently of management, CCGG recommends that the chair should "regularly" hold meetings with the non-executive directors without executive directors present rather than just "periodically".

4. Section 3.1 – It is CCGG's view that directors should be elected annually in order for them to be truly accountable.

5. Section 3.4 – CCGG is of the view that shareholders should be able to nominate director candidates directly onto the company's proxy if they own 3% or more of the voting shares. A higher threshold is unrealistic and unduly onerous for shareholders. Accordingly, the Principles should indicate that providing shareholder access to the proxy at a 3% level is a best practice.

6. Section 3.8 - The requirement that the board should disclose "any material issues of relevance arising from the conclusions [of a board evaluation] and any action taken as a consequence" sets up unrealistic expectations. Boards may find it challenging to attract directors if there is a concern that negative reviews of their performance on an individual basis will be made public.

[2] See CCGG's Governance Differences of Equity Controlled Corporations at http://www.ccgg.ca/site/ccgg/assets/pdf/Gov_Differences_of_Equity_Controlled_Corps_FINAL_Formatted.pdf and Dual Class Share Policy at http://www.ccgg.ca/site/ccgg/assets/pdf/dual_class_share_policy.pdf

7. Section 5.2 – Given the growing recognition of the importance of environmental and social risks to a comprehensive approach to risk oversight, CCGG recommends that environmental and social risks be explicitly enumerated along with financial, strategic, operational and reputational risks. Although arguably falling within some of the enumerated categories, the significance of potential environmental and social risks warrants their own reference. They also are explicitly referenced in Section 9.3(c) as important areas for asset owners to consider in fund manager contracts.

8. Section 6.3 - CCGG is of the view that it is important for boards to make substantive disclosure of how remuneration awards are appropriate in the context of the company's overall *strategy*. Shareholders want to know how the compensation system is structured so as to incentivize management to achieve the company's long term objectives. We recommend that a statement to this effect be included in section 6.3.

9. Section 6.4 – CCGG believes that directors and management should not be able to hedge their exposure to the company's shares (or that there should be a specified minimum quantum of equity exposure that cannot be hedged) and that the Principles should include this as a guideline rather than merely requiring disclosure of hedging policies.

10. Section 6.6 –CCGG's Principles of Executive Compensation[3] caution against the over reliance on pay benchmarking in setting executive compensation and state that the quantum of compensation awarded to executives should be determined within the context of the organization as a whole. Perhaps the Principles could incorporate the idea that executive compensation should be reasonable from this perspective.

11. Section 6.6 –A portion of cash-based remuneration is usually comprised of salary. Salary is generally not related to performance but instead is designed to reflect reliable compensation for service, ability and expertise. Assuming that the section is referring to cash bonuses, the word "incentive" should be added between "employee" and "remuneration' in the fifth line to exclude salary.

12. Section 7.8(e) - For clarification we suggest adding a statement explaining the purpose of monitoring non-audit fees, that is, to ensure that they do not compromise auditor independence. The provision that non-audit fees should normally be less than the audit fees could be provided as an example of that principle.

13. Section 8.3 – In addition to stipulating that dual class share structures should be regularly approved by shareholders, CCGG is of the view that the following principles[4] should apply to companies with dual class shares and that they should be included in the Principles:

    - Holders of multiple voting shares should be entitled to nominate a number of directors equal to the least of (i) two/thirds of the board, (ii) the number obtained when the board size is multiplied by the percentage of total voting rights held by the multiple voting shares, and (iii) if the holder of multiple voting shares are related to management of the controlled company, then one-third of the board.

[3] http://www.ccgg.ca/site/ccgg/assets/pdf/ccgg_publication_-_2013_executive_compensation_principles.pdf
[4] See CCGG's Dual Class Share Policy cited above.

- Holders of multiple voting shares must have a meaningful equity ownership stake in the company.

- All dual class share companies which are public should have protection for minority shareholders in the event of a takeover bid.

- Holders of multiple voting shares should not be allowed to monetize the shares by entering into a derivative transaction or other form of hedging.

14. Section 8.6(b) – Canadian law, as well as Canadian stock exchange rules, do not require pre-emptive rights to existing shareholders. CCGG does not see a need for such a requirement in Section 8.6(b)

15. Section 8.4 – Many of CCGG's members disagree with the statement that "Every company should be entitled to require registered owners to provide the company with the identity of beneficial owners or holders of voting rights where applicable". It is the position of many of CCGG's members that beneficial shareholders should be entitled to remain anonymous. Canada currently has a proxy voting system that allows for this anonymity to be maintained.

16. Section 8.7 – In CCGG's view the statement that "Shareholders should be able to work together to make such a proposal' should be added back in, since CCGG believes it is appropriate that shareholders be able to aggregate their holdings to meet shareholder proposal thresholds.

Section 2: Shareholders

Do you have any comments with regards to the drafting of the principles in 'Section 2: Shareholders' and are there any other recommendations you believe that the ICGN should include?

We believe that **Section B: Shareholders** of the Principles should more clearly reflect the following, as stated in our comments above on the Preamble:

- The applicability of the Principles may vary depending on whether the shareholder is an asset owner or asset manager
- Recognize the legitimacy of a whole spectrum of engagement from proxy voting to the exercise of governance rights (such as seeking board representation) and that for some investments, voting alone is appropriate and sufficient engagement depending on the issues and circumstances

We have the following specific comments:

1. Section 9.2 – Add the phrase "including" before "prudence, care and loyalty" following "fiduciary duties" to make clear that there may be other elements of fiduciary duty depending on the jurisdiction.

2. Section 9.3 – Clarify the section by redrafting it to read "Asset owners should effectively monitor their fund managers in respect of such contracts by requiring that agents report relevant information, including the delivery of investment objectives."

3. Section 9.3 b) – Rephrase so that the section reads "setting out an appropriate internal risk management framework so that material risks are managed effectively".

4. Section 9.3 d) – Query whether you can contract for a culture.

5. Section 9.3 e) – Amend the section to recognize that there is a spectrum of acceptable engagement from less to more active depending on the circumstances (with proxy voting on one end moving through engagement to actively seeking governance rights and board seats)

6. Section 9.3 f) – Replace "appropriate " with "relevant and high quality"

7. Section 9.4 – With respect to "deemed helpful to the delivery of value" - clarify to whom the value is to accrue, (e.g. is it to clients or the broader market) and over what time horizon

8. Section 10.1 –Suggest rewording section. It is not clear what the phrase "that can hold them effectively accountable" is referring to and clarification is needed: is the point that investment funds must be held primarily accountable to beneficiary or client interests?

9. Section 10.1 –The section states that "The way in which individuals are appointed to serve on the governing body should be disclosed to beneficiaries and others…" Who would those others be, e.g. clients?

10. Section 10.1 –The section suggests that the shareholders' governing body should include "representation from relevant interests". That statement is ambiguous and could be problematic. For example, does a board need to take into account groups such as union representatives? We would argue that a board with broader stakeholder interest groups may not be appropriate and that, rather, it is important that a board have investment expertise and be transparent and accountable. More guidance as to what constitutes "relevant interests" would be useful. Also, the sentence "Such criteria should always take account of the need for expertise and understanding of the matters for which the governing body is responsible" has been removed and CCGG believes that it expresses an important point and should be retained.

11. Section 10.2 – While some of CCGG's members do actively solicit feedback from beneficiaries or clients, on the whole the majority believe that it is sufficient to have a clearly disclosed method for providing feedback. And while some of CCGG's members do have an independent review of their internal governance structures, most feel that governance structures that are properly monitored and assessed internally is adequate given that we do not require investee companies to carry out independent reviews of internal governance structures.

12. Section 11.3 – Clarify what is meant by "broader ethical considerations" since the section can be interpreted as referring to ethical investing, or portfolio exclusions based on certain criteria, perhaps by starting the following sentence with "For example,"

13. Section 11.3 – We suggest a wording change in the fourth line: replace "robust" with "effective".

14. Section 12.3 – We suggest replacing "culture" with "performance" or "investment behaviour" and "context" with "alignment" in the sixth line and seventh line, respectively.

15. Section 13.3 – Consider moving this section under the heading "**14. Investee company monitoring"** between 14.2 and 14.3.

16. Section 13.3 – We recommend including the concept of degrees of active ownership in this section; for example, in many or perhaps even most cases shareholders may monitor the governance of investee company boards only if they have a sufficient ownership percentage.

17. Section 13.3 – Add a reference to monitoring the performance of the investee company as well as the governance of investee company boards.

18. Section 13.3 – Unclear what "may be tied in part to such analyses" means

19. Section 13.3 – Unclear what "agreed levels of responsibility" refers to.

20. Section 13.4 – Should strengthen statement beyond "should *consider* ways to consolidate, collaborate etc." Also, add "outsourcing" as an option if an shareholder has insufficient resources.

21. Section 14.1 – The recommendation that shareholders should inform an investee company's board if they intend to vote against a management proposal or to abstain, ideally in writing, at least in respect of significant holdings, is not supported by all of CCGG's members for all situations. There may be legitimate reasons why shareholders may not want to disclose how they intend to vote in advance of the meeting. In any event, the volume and time constraints during proxy season may make it difficult for shareholders to communicate their voting intentions in advance. Also, similar to the principle underlying anonymity in democratic political elections, some of CCGG's members believe that shareholders should have the right to have their vote remain confidential and shareholders should be free to choose whether or not to disclose how they vote. Making shareholders' voting policies public in some cases should be sufficient to communicate voting patterns to companies.

22. Section 14.2 –Clarify if this section is referring to the annual report

23. Section 14.2 – The section suggests that when shareholders uses external services for analyzing and monitoring portfolio companies for strategy, risk oversight and risk management they should consider disclosing the name of the service provider and the nature of the mandate. It is not always customary, nor do we believe always necessary, to disclose the names of advisors or the risk tools used by the shareholder, though this may be appropriate if the shareholder is an external manager to a plan sponsor.

24. Section 14.2 – Include governance in the list of the matters for which portfolio companies are monitored.

25. Section 14.3(b) – Recommend introducing concept of materiality into considering "all relevant factors".

26. Section 15.1 – This section should clarify that shareholders should see to identify as early as possible "governance issues" that could put the investment value at risk since identifying problems that put an investment value at risk generally is typically seen as the basic investment function and not just a governance matter. It can also be a matter of proprietary investment expertise on the part of the shareholder. It may not be appropriate when viewed in this light to prescribe that the investee company board or management should be made aware of the shareholders' concerns.

27. Section 15.2 – The section should make it clear that (i) in addition to any ability shareholders have to communicate with management and executive directors, shareholders must have the ability to communicate with the independent directors if the situation warrants it in their view and (ii) part of the responsibilities of independent directors is to communicate with shareholders if requested by shareholders.

28. Section 15.2 – Perhaps the section could recognize that at times the appropriate response of shareholders is to sell or short a security when all engagement efforts fail.

29. Section 16.3 – Why does the question of scale only show up here in the discussion of voting? Isn't it relevant in other forms of engagement, in fact, more so? The section could also refer to not voting because of share blocking or other impediments.

Annex

Do you wish to recommend any words for inclusion in the definition section? If so, please identify and define the word.

CCGG has no recommendations with respect to the definition section.

We thank you again for the opportunity to provide you with our comments. If you have any questions regarding the above, please feel free to contact our Executive Director, Stephen Erlichman, at 416.868.3585 or serlichman@ccgg.ca or our Director of Policy Development, Catherine McCall, at 416.868.3582 or cmccall@ccgg.ca.

Yours very truly,

Daniel E. Chornous, CFA
Chair of the Board
Canadian Coalition for Good Governance