Written Submission to the National Roundtables on Corporate Social Responsibility and the Canadian Extractive Sector in Developing Countries

by

Social Investment Organization
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We are writing on behalf of the members of the Social Investment Organization, the national association for socially responsible investment. Our members include more than 400 staff and directors of financial institutions, asset management firms, fund companies, investment consultants, financial advisors and investors. Our members are committed to the development of socially responsible investment, which is the application of environmental, social and governance considerations to the selection and management of investments. Our members serve more than half a million Canadian depositors and investors.

With this submission, we are responding to your request for comments on ways to strengthen approaches to managing the external impacts of Canadian corporations operating abroad, particularly with reference to the extractive sector. While your call for comments is quite broad – incorporating recommendations for government, NGOs, labour organizations and business associations -- we want to confine our remarks to policy proposals for government. Since your report will be to Parliament, we want to provide Parliament and the federal government with practical, actionable recommendations.

We want to commend the government of Canada for this initiative. The investment community has an interest in the long-term shareholder value of Canadian corporations operating abroad. The social responsibility of our companies abroad is an increasingly critical factor in determining long-term investment risk and returns. We thank you for this opportunity to explain our viewpoint, and to offer recommendations for government policy.

Further, with recent major increases in commodity prices, there is even greater interest in the CSR policies of the extractive sector. Recent price increases for minerals, oil and gas are generating new development possibilities around the world. Higher prices are creating incentives for unprincipled development of new mines or oil or gas fields without concern for local labour standards, environmental conditions or human rights. This forum is, therefore, a timely examination of these issues.

Eugene Ellmen
Executive Director
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CSR Policies, Fiduciary Responsibility and Shareholder Transparency

There is a growing consensus in the investment community that environmental, social and environmental (ESG) factors are an important component of prudent risk management and a source of added portfolio value. The emerging view is that investment trustees and managers must incorporate social and sustainability analysis into their investment policies and decisions in order to be responsible fiduciaries. Social and environmental analysis is an integral part of a well-managed portfolio. A growing body of evidence shows that corporations with positive social and environmental records can have superior stock performance over the long term.

For example, numerous socially responsible stock indexes, including the Domini Social Index in the US (www.kld.com) and the Jantzi Social Index (www.jantziresearch.com) in Canada, have outperformed their conventional benchmarks.

Research studies have also found that there is no sacrifice for investing in a socially responsible way. A report commissioned by the Asset Management Working Group of the United Nations Environment Program Finance Initiative (UNEP FI) found that there is investment value in integrating responsibility and sustainability issues into portfolio analysis. The report, entitled *The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing,* compiles research by 12 internationally-recognized investment companies. (www.unepfi.net/stocks).

Major Canadian institutional investors are beginning to recognize the wisdom of this approach. Earlier this year, the Canada Pension Plan Investment Board (CPPIB), the British Columbia Investment Management Corp., the Caisse de depot et placement du Quebec, and a number of smaller institutional investors, signed on to the United Nations Principles for Responsible Investment (UNPRI). The UNPRI pledges signatories to research and consider a number of socially responsible investment strategies. (www.unpri.org/) As well, the CPPIB has become the first Canadian signatory to the Enhanced Analytics Initiative, an international group of investors establishing incentives for non-traditional investment research. (http://www.enhancedanalytics.com/)

Recent changes in our understanding of the law of investment are helping to drive this new activity. Traditionally, the consensus in the legal community was that socially responsible investment was contrary to the fiduciary duty of investment trustees and managers. However, a recent comprehensive legal analysis conducted by the prestigious UK law firm of Freshfields Bruckhaus Deringer found the traditional consensus to be untrue. The study found that, contrary to widespread belief that incorporation of ESG factors is prohibited by fiduciary obligation, the law permits the integration of ESG issues and, arguably, requires such integration. (http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf)

Corporate social responsibility (CSR) is playing a key role in this emerging investment framework and is becoming recognized as a driver of shareholder value. Companies that treat their local communities well, respect international covenants on labour and human rights, avoid environmental catastrophes, and provide decent wages and benefits deliver solid long-term returns for investors. They are also the companies that are likely to avoid reputation, operational and legal risks, CSR factors that depress share prices over the long term.

Obviously not all Canadian companies will agree on the need for higher CSR policies. Some companies will take advantage of low-wage jurisdictions in developing economies, or loopholes in local laws to operate with low CSR standards.

But these kinds of companies will not attract long-term investment, particularly from major institutional investors. Because of this, the Social Investment Organization believes that it is good public policy for the government of Canada to encourage corporate responsibility among Canadian companies at home and abroad. We also believe that governments must ensure that corporate and securities laws reflect a concern with CSR, so that Canada can become a leader in CSR governance and disclosure. By encouraging companies to adopt progressive CSR policies, and establishing rules on CSR disclosure and governance, the government can help to build capital markets that reward corporate social responsibility.

Recommendations

Encouraging better disclosure through the Global Reporting Initiative

Many Canadian corporations – including companies in the extractive sector – are world leaders in the area of sustainability reporting. Voluntary reporting is embraced by these firms, and the sustainability reports they produce have been recognized worldwide.

However, for the vast majority of companies, non-financial reporting fails to meet investor requirements.

In the discussion paper published by the Department of Foreign Affairs and International Trade for the CSR Roundtables (http://international.gc.ca/cip-pic/library/CSRDiscussion%20Paper.pdf), DFAIT discusses the role of securities legislation in creating incentives to support CSR standards, concluding that such legislation has had a “limited impact” on CSR disclosure.

While securities legislation in theory requires companies to disclose social and environmental information that is material to shareholders, there is significant evidence to show that typical disclosure is inadequate. Nola Buhr and Marty Freedman (*A Comparison of Mandated and Voluntary Environmental Disclosure: The Case of Canada and the United States,* http://panopticon.csustan.edu/cpa96/pdf/buhr.pdf) find that the extent of disclosure is "woefully inadequate" in Canada and the US. Furthermore, there are some resource-based companies that choose to disclose nothing about their effect on the environment.

This finding is not surprising. A review of continuous disclosure by the Ontario Securities Commission (OSC Staff Notice 51-708) found that companies frequently fail to adequately discuss key Management’s Discussion & Analysis requirements, including "qualitative and quantitative risk factors that could have an effect on future operations and financial position." Such risk factors include a host of social and environmental issues that have an impact on short- and long-term share price.

Another problem with the current reporting framework is that companies produce CSR reports using a variety of different indicators and metrics. The result is a confusing mix of information and data that is difficult for investment analysts to interpret, making judgments between companies a difficult task.

In response to this dilemma, a group of companies, stakeholders and investors have launched the Global Reporting Initiative (GRI), a reporting framework for corporations to provide detailed disclosures on key socially responsible and sustainability issues. The GRI Reporting Framework is continuously improved through stakeholder engagement that involves reporting organizations and information seekers, who develop revisions through a process of consensus. Nearly 1,000 organizations in over 60 countries have used the GRI Framework as the basis for their reporting. (http://www.globalreporting.org/)

The GRI framework is comprehensive, and permits investors to collect and analyze data in a systematic way, permitting company comparisons and making judgments on CSR criteria much easier. Currently, however, only 34 Canadian companies or organizations report to the GRI framework.

Clearly, the current system of CSR reporting is inadequate and needs to be bolstered. Provincial securities acts could be amended to require publicly listed companies to report to the GRI framework. The Canadian Securities Administrators could approve similar regulations. However, the federal government also could have a potential role to play in this by requiring, as a matter of federal corporate law, that all publicly listed companies chartered under the Canada Business Corporations Act (CBCA) be required to issue annual GRI reports. Most major Canadian companies are chartered under the CBCA, so such a requirement would have far-reaching effects in improving CSR disclosure in Canada. Under the CBCA, the act is supposed to be scheduled for a regular five-year review this Fall, so work on this issue could start immediately as part of this review.

Recommendation #1
The SIO recommends that the CSR Roundtable and the government of Canada support amendments to the Canada Business Corporations Act to require publicly listed companies chartered under the CBCA to issue annual GRI reports.

Improving CSR disclosure and governance through securities regulation

In recent years, much attention has been focused on the shaken confidence of the world's capital markets resulting from the corporate abuses of Enron, WorldCom and other companies. There have also been scandals at Canadian companies that have reduced investor confidence here. The SIO believes this crisis of confidence involves more than just accounting and auditing abuses. We believe that these examples of corporate malfeasance are indicative of a larger underlying problem in which some companies emphasize short-term profit and capital appreciation at the expense of stakeholders, including investors.

One of the most effective ways of addressing this problem is through the creation of an effective CSR continuous disclosure and governance mandate through securities rules.

The SIO believes that Canada needs to dramatically improve securities regulation. In the past, we have supported the creation of a national securities regulator with a mandate to improve corporate disclosure, transparency and accountability on CSR activities. It is uncertain where the debate about a national regulator is heading, but it is clear that Canada needs to improve its CSR disclosure framework.

Corporations are now facing a growing global consensus that socially responsible disclosure and governance is a requirement. Denmark introduced a law on mandatory "Green Accounts" for large companies in 1995. France followed in February 2002 with legislation requiring listed companies to include social and environmental evaluations in their annual reports. Norway and Sweden also have legislation requiring companies to disclose financial consequences of the environmental impacts of corporate operations. Just this year, Germany introduced new rules requiring companies to disclose material information on sustainability-related key performance indicators. As well, the 2002 King Report on Corporate Governance in South Africa now mandates directors of companies listed on the Johannesburg Stock Exchange to undertake Social and Ethical Accounting, Auditing and Reporting (SEAAR) exercises as well as safety, health and environment (SHE) disclosures.

And while the UK government recently cancelled its proposed Operating and Financial Review – including mandatory social and environmental reporting – the government is proceeding with a consultation on appropriate corporate reporting.

As more countries adopt a socially responsible disclosure and governance regime, Canada risks falling behind important international standards on these issues. It is important for Canada to implement a national socially responsible disclosure and governance framework to stay current with developments in Europe and elsewhere. It is critical for the federal and provincial governments to move forward in this area, whether it is through a national regulator, or a bolstered “passport system,” which is currently being implemented by the Canadian Securities Administrators.

While the federal government does not have jurisdiction in this area, it does hold significant moral suasion and could provide support and assistance for the creation of better CSR disclosure, transparency and accountability through securities regulation.

Recommendation #2
The SIO recommends that the CSR Roundtable and the federal and provincial governments support creation of a comprehensive CSR disclosure, transparency and accountability framework as part of the national securities reform project currently underway.

Mandating disclosure of CSR policies and proxy voting by Canadian pension funds

In addition to improving the corporate CSR disclosure regime through a national securities regulator and the CBCA, SIO also believes it is important for the government to establish new pension rules requiring pension funds to disclose their CSR investment policies and how they use the power of their shareholder votes.

Given the enormous clout of pension funds in the capital markets, we believe that the issue of pension transparency is more than just a technical investment issue. It is an important governance issue in the investment industry with public policy ramifications extending to the CSR debate at the heart of these Roundtables.

The SIO believes that pension plan members have a vital interest in knowing that their pension plans are being properly managed – including knowledge of the important long-term non-financial factors that could increase the risk to their pension assets or future returns. We believe that pension plan members have a right of access to such information.

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Under current rules, Canadians have no way of knowing if their pension plans have investment policies related to the CSR activities of the companies in their portfolios. Pension plan members also have no right of access to information on the shareholder votes cast by their funds, or the policies determining those votes.

The SIO has raised these issues with the federal government during its recent consultation on defined benefit pension plans in the federal sector. We submitted a brief to the consultation and met with staff of the Department of Finance to discuss our concerns. The brief is located at http://www.socialinvestment.ca/Policy&Advocacy/Pension%20Disclosure%200805%20Brief.pdf.

Our position is based on three key points:

- Social and environmental policies and proxy voting benefit pension plans by reducing long-term risk and enhancing returns
- Pension plans have a fiduciary duty to take social and environmental factors into account, and to vote their holdings on behalf of their beneficiaries
- Pension plan members have a right to know what social and environmental policies are in place, and how their pension plans have voted their assets.

In what we call our *Pension Right to Know Package*, the SIO has called for regulations that would require pension plans to disclose their social and environmental policies, as well as their proxy voting policies and voting records. The social and environmental disclosure rules are similar to recent legislation in the UK, France and Germany. The proxy voting rules are similar to rules now in effect for mutual funds in Canada and the United States.

On proxy voting, the SIO believes that not only do pension funds have a fiduciary duty to vote their shares on behalf of their plan members, but that plan members have a right to know how their assets are being voted. The fiduciary duty that funds have to cast their votes appropriately is only meaningful if it is accountable, and the accountability mechanism is to the trustees that oversee the plans. Without disclosure of voting policies and records, pension plan members and their trustees have no way of knowing if plans are in fact acting according to their fiduciary duty when voting their shares. Transparency on voting policies and records is essential.

We believe that the *Pension Right to Know Package* would provide important new information to plan members about the long-term management of their pension assets. As well, the Package would provide a level of transparency that would enhance the practice of social and environmental assessment and proxy voting through the investment community in Canada. This would result in better risk management in the future and improve long-term pension fund returns. It would provide an indirect incentive to corporations to improve their CSR activities by becoming more attractive long-term investments.

Recommendation #3
The SIO recommends that the CSR Roundtable support our call for the Pension Right to Know Package, and that the Department of Finance implement our recommendations at the earliest opportunity.

Improving CSR performance standards in the mining industry

As investors with an interest in improving corporate social responsibility, many of our members are actively involved in the debate about CSR performance standards in various sectors.

The Ethical Funds Company, Inhance Investment Management, Meritas Mutual Funds, Batirente and other SIO members have proposed or supported shareholder resolutions with companies encouraging adoption of various performance standards. The debate about performance standards therefore is a significant point of discussion in the investment sector.

Institutional investors are increasingly interested in encouraging companies to adopt leading industry performance standards as a means to commit to a high level of performance on corporate social responsibility issues. Such commitments provide assurance to investors that signatory companies have assessed their CSR risks, and have taken measures to address such risks. Such signatories then become more attractive candidates for investment.

We commend to you the written submission made by The Ethical Funds Company, *A CSR Framework for Canadian Extractives.* The submission reviews the various performance standards available to the mining industry, and recommends adoption of the Mine Certification Evaluation Project (MCEP). It is apparent that the MCEP fulfills the chief criteria for adoption as a CSR performance standard; namely, that it is industry-leading, established through a multi-stakeholder and transparent process, and that it is amenable to audits and other forms of assurance.

Recommendation #4
The SIO supports The Ethical Funds Company recommendation that the CSR Roundtable endorse the MCEP, and that the federal government establish a working group to refine the MCEP principles for the extractives sector.

Improving CSR through the extension of Canadian law to Canadian companies operating abroad

In its report, the SCFAIT recommended that the government "establish clear legal norms in Canada to ensure that Canadian companies and residents are held accountable when there is evidence of environmental and/or human rights violations associated with the activities of Canadian mining companies."

In its response, the government argued that this would be an extra-territorial application of Canadian law, which "could raise several problems, including conflict with the sovereignty of foreign states; conflicts where states have legislation that differs from that of Canada; and difficulties with Canadian officials taking enforcement action in foreign states."

The legal complexities of this issue are beyond our expertise at the SIO. However, we would like to make the simple point that we believe that Canadian corporations should be accountable under Canadian law when there are gross violations of CSR standards. As we explained earlier, the financial industry is coming to the view that investment in responsible, sustainable corporations will provide enhanced long-term returns and lower risk for shareholders. Certainly, the disclosure and governance provisions recommended above would do much to help create an environment supporting greater CSR activity by Canadian corporations abroad.

Therefore, we support the call by the Standing Committee for stronger legislation to make Canadian corporations abroad accountable under Canadian law. As investors in Canadian and international corporations, our members believe that it is important for companies operating in developing countries to have clear, transparent rules governing those operations. While such legislation could create a higher standard for Canadian-based companies than companies headquartered in other countries, we believe that Canadian values should determine the CSR activities of Canadian companies operating abroad. And the best, most transparent way of achieving this is through application of Canadian law.

Recommendation #5
The SIO urges the CSR Roundtable and the Government to commit to the development of a legislative framework clarifying how Canadian corporations operating abroad can be made accountable to Canadian law when there are CSR abuses.

Protecting our CSR infrastructure from foreign takeovers

The proposed acquisition of Noranda by the Chinese state corporation Minmetals in 2004 raised serious concerns about the vulnerability of Canadian companies to takeover by companies in countries without a CSR disclosure regime. While that particular proposed takeover was never completed (Noranda merged with Falconbidge and the merged company was eventually taken over by Xstrata of Switzerland), it illustrates the vulnerability of Canadian companies to takeover by companies in countries without clear CSR disclosure regulations.

This is one aspect of what many observers are now calling the “hollowing out” of corporate Canada, a process in which foreign takeovers appear to be depleting our head offices of executive and managerial talent, a process that could lead to a serious loss of Canada’s intellectual capital.

The Social Investment Organization is particularly concerned about the potential CSR impacts of such takeovers. State-owned corporations in foreign jurisdictions are not subject to continuous disclosure provisions mandated by securities commissions and accounting bodies. Likewise, public companies in some emerging markets are able to operate under much lower disclosure requirements than companies in developed nations. Canada could put in place provisions such as the disclosure and legal reforms recommended above that would dramatically increase our CSR infrastructure, only to have these reforms made irrelevant in a round of foreign takeovers bringing large numbers of Canadian companies under foreign jurisdiction. This would have a large and harmful impact on CSR policies and practices.

The Canada Investment Act gives the federal Minister of Industry the power to reject foreign takeovers of Canadian companies if the Minister, upon review, determines that the investment is not of “net benefit” to Canada. In determining whether an investment is of "net benefit", the Act obliges the Minister to consider the following: the level of economic activity; participation by Canadians in the business; the effect of the investment on productivity, efficiency, technological development, innovation and product variety; competition impacts; compatibility with national industrial, economic and cultural policies; and the impact on Canada's ability to compete in world markets.

Given the importance of CSR disclosure and standards mentioned above, the SIO also believes that the federal government should take into consideration the impact of the investment on corporate disclosure and corporate social responsibility standards in assessing foreign investments for their net benefit.

The tendency of Industry Canada in reviewing takeovers under the Act has been to approve them, sometimes negotiating concessions to improve the net benefit. In the case of CSR disclosures and standards, the government may have to take a stronger position, and be prepared to reject proposals from companies operating under poor CSR disclosure regimes or with poor CSR standards.

Recommendation #6
The SIO urges the CSR Forum to recommend to the federal government that it include an assessment of the impact on CSR disclosures and standards of any proposed takeover under the Canada Investment Act.

Conclusion

Assessment of a corporation's CSR history and practice is becoming an important element in the decision by investors to invest in these companies, or in voting their holdings. As such, investors need timely information on the CSR policies and practices of corporations. As well, investors support legal mechanisms and standards to encourage companies to improve their CSR performance.

The recommendations above – if implemented -- would achieve a number of important reforms. They would enhance the disclosure regime, making corporations more open and transparent on CSR issues. They would make Canadian companies operating abroad subject to Canadian law, introducing legal remedies for gross violations of CSR standards. They would help to introduce a new CSR performance standard for Canadian mining companies, helping to make the Canadian mining sector a world leader on CSR issues. And they would give the federal government the power to review CSR issues when determining whether foreign takeovers of Canadian companies are a net benefit to Canada.

These reforms – as a package – would help to move Canada forward on the CSR agenda, and help to make Canada a leading jurisdiction in CSR public policy. They would also help to create an environment of responsibility and sustainability for Canadian corporations, a situation that would lead to better investor returns with lower risks.