Shareholder Association
for Research and Education

MODEL PROXY VOTING GUIDELINES

2005

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Disclaimer: These guidelines are provided as a model for pension funds in developing their proxy voting policies and procedures. They are not to be taken as legal advice. Pension funds are strongly advised to seek independent legal and financial advice in developing their proxy voting procedures to best suit the interests of their plan members.

About SHARE

The Shareholder Association for Research and Education (SHARE) is a national non-profit organization originating within the labour movement. SHARE works with institutional investors to promote socially, economically, and environmentally responsible investment practices through research, educational activities, and advocacy.

About these guidelines

These guidelines have been developed by SHARE as a model for use by Canadian pension funds. The guidelines were written with companies using an Anglo-American or unitary board structure in mind; however, most of the guidelines will also be useful for companies that use other board structures. The guidelines are written in the first person — "[the fund]" — to make them similar to guidelines that would be adopted by a board of trustees.

In addition to having a set of proxy voting guidelines, pension funds should also ensure that plan documents provide the appropriate authority for trustees to execute or delegate the execution of their voting rights and that procedures for proper accountability are in place. For information about the incorporation of proxy voting policies in plan documents, please refer to the SHARE publication *How to Incorporate Active Trustee Practices into Pension Plan Investment Policies*. More information about proxy voting procedures and how to order publications is available on the SHARE website at www.share.ca.

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SHARE especially thanks our Proxy Voting Guidelines Advisory Committee, who once again provided invaluable advice and guidance on this revision of the guidelines. They are:

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The views expressed in this document are those of SHARE and do not necessarily reflect the views of the Advisory Committee, their organizations or affiliates.

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FORWARD

The Shareholder Association for Research and Education is pleased to issue SHARE's 2005 Model Proxy Voting Guidelines.

SHARE's first proxy voting guidelines were published in 2002, at a time when the actions of Boards of Directors, auditors, and executives of publicly traded companies were coming under increasing scrutiny by investors. Since then, the number of closely-contested proxy votes at annual meetings has grown rapidly. Clearly, the responsibility for voting proxies is more important than ever for the trustees of worker pension and benefit plans and other funds.

These updated guidelines reflect our commitment to address emerging issues and incorporate new standards, such as the revised Principles of Corporate Governance approved by the Organization for Economic Cooperation and Development (OECD) in 2004. The trade union movement actively participated in the debate leading to their approval and continues to monitor and intervene in discussions on corporate governance through the Trade Union Advisory Committee to the OECD. The revisions to the SHARE guidelines also incorporate expanded support for shareholder proposals seeking greater disclosure about how companies are addressing risks related to climate change.

The guidelines continue to emphasize the important role of a company's Board of Directors. Boards should be diverse and should be led by an independent Chair. All key board committees, including the Audit, Nominating and Compensation committees, should consist entirely of independent directors.

We encourage you to use these guidelines to develop and evaluate your own proxy voting policies and your on-going oversight of the voting of proxies. So equipped, active trustees can play an increasingly effective role in safeguarding the retirement security of working Canadians.

Kenneth V. Georgetti
Chair, Board of Directors,
Shareholder Association for Research and Education

1. GENERAL PRINCIPLES

1.1 Proxy voting responsibilities

[The fund] manages its assets in a manner that will provide benefits to plan participants and their beneficiaries over a span of many decades. Consequently, the actions of the fund must support their long-term interests.

Equities held by [the fund] usually carry voting rights. Voting rights are valuable assets of [the fund], and trustees have an obligation to ensure that shares owned by the plan are voted in a way that supports their participants' interests over the long term.

1.2 Duties of loyalty and prudence

The trustees of the fund and anyone appointed to vote proxies on their behalf have a duty of loyalty to exercise their proxy voting authority solely in the interests of plan participants and beneficiaries. They have a duty of prudence to exercise their proxy voting authority with the care, skill, and diligence that a prudent person would exercise in managing the property of others.[1] Failing to vote the plan's shares, voting without consideration of the effects, or voting arbitrarily with or against management violate these duties. Those who are responsible for voting [the fund's] shares also have a duty to take reasonable steps to ensure that they receive and act on the proxies for all stocks owned as of the record date.

The duties of loyalty and prudence also mean that trustees and the fiduciaries to whom they delegate their voting authority have a duty to communicate to the companies in which the plan invests about which courses of action would, in their view, be in the best interests of plan participants. This includes encouraging companies to adopt the current best practices in corporate governance and corporate social responsibility, because those practices will enhance shareholder value in the long term.

1.3 Application of these guidelines

[The fund] will vote its proxies in accordance with these proxy voting guidelines. These guidelines apply to Canadian and international companies. Hence, in some cases the guidelines address issues that arise in other countries, as well as issues that arise in Canada.

In deciding how to apply the guidelines, [the fund] will give consideration to the circumstances of each vote as well as to the general principles contained in these guidelines. If it is not clear how to interpret or apply the guidelines for a particular vote, decisions on how to proceed should be based on what will best serve the long-term interests of plan participants and their

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[1] The definition of the duty of care varies from province to province. The definition above complies with the general spirit of all of them. However, fiduciaries should consult the specific definition for their province. *See*, Gil Yaron, "The Responsible Pension Trustee: Re-Interpreting the Principles of Prudence and Loyalty in the Context of Socially Responsible Institutional Investing." *Estates, Trusts & Pension Journal* Vol. 20(4) June, 2001, pp. 305-388.

beneficiaries. This may include deviating from these guidelines, if doing so would best serve participants' interests in the long term. Those responsible for voting may need to seek out information from a variety of sources and consult with trustees to determine what is in the long-term best interests of plan participants and beneficiaries.

- [The fund] will vote in a manner that is consistent with the duties of loyalty and prudence, and with the current best practices in corporate governance and social responsibility.

- Above all else, [the fund] will always vote in the best long-term interests of its participants and their beneficiaries. If questions arise about the application or interpretation of these guidelines for any issue, they should be resolved by taking the course of action that will best serve the interests of participants and beneficiaries in the long term.

[The fund] will not attempt to manage companies by shareholder referendum, and will ensure that any attempts to influence a company do not harm its financial viability.

1.4 Retention of voting authority

In cases where the fund delegates to external investment managers or a proxy voting service the authority to vote on its behalf, it reserves the right to direct the vote on any particular resolution or issue.

1.5 Annual review of guidelines

The best practices and standards for corporate governance and corporate social responsibility evolve over time and new proxy issues emerge each year. These guidelines will be reviewed, updated, and approved by [the fund's] investment committee on an annual basis.

2. INSTRUCTIONS FOR VOTING PROXIES

[We encourage funds to put their instructions or procedures for voting proxies in this section of the guidelines. Instructions and guidelines vary greatly from fund to fund, depending on the extent to which responsibility for proxy voting is delegated, and how and to whom it is delegated. For more information or guidance on proxy voting procedures see *How to Incorporate Active Trustee Practices into Pension Plan Investment Policies* on SHARE's web site, at www.share.ca]

Any investment manager or adviser who, under the terms of a contract, is responsible for voting the stock held by [the fund] is expected to follow these proxy voting guidelines in making voting decisions, unless deviating from these guidelines would best serve the plan's participants in the long term.

2.1 Reporting requirements and transparency

[The fund] will make copies of these guidelines available on request to all companies in which we invest, to any plan participant, and to the public. We will also provide plan members a summary of our proxy-voting record annually. [The fund's] full voting record on all issues is available to plan members upon request.

Where voting decisions have been delegated, trustees must monitor these voting decisions in as part of their duty to manage the fund in the best interests of the plan members. The fiduciary responsible for voting should report regularly to the trustees on how he/she has voted each proxy. This report should include a written justification for any vote that deviates from these guidelines, and the outcome of the votes at the shareholders' meeting. [The fund] and its voting fiduciary will agree on the details, timing, and frequency of these reports at the beginning of the fiduciary's contract, and review their agreement annually.

3. CORPORATE GOVERNANCE

3.1 General guidelines

Good corporate governance is based on the relationships between shareholders, the board of directors, and the management of a company. The shareholders are the company's owners. The company's management, led by the CEO, runs the company and works for the shareholders. The Board of Directors acts on behalf of the shareholders to oversee management. The relationships between these three bodies are vital to a company's success.

3.1.1 Amendments to Articles of Incorporation or Articles of Association

In general, all major changes in a corporation should be submitted to a vote by shareholders.

Proposals to amend a corporation's articles of incorporation or association are usually made as a response to changes in the rules, laws, or regulations affecting the corporation, such as changes in stock exchange listing rules. Most of these changes are technical and administrative matters that will not affect shareholders' interests. However, the wording of these amendments must be carefully considered because small changes in the wording of an article can have a significant effect on corporate governance.

Management will often combine all of the amendments into one item to be voted on in the proxy form. This makes it impossible for shareholders to approve some amendments but vote against others that may be not in their interests. [The fund] encourages companies to give shareholders the opportunity to vote separately on all amendments.

- [The fund] will assess proposals to amend Articles of Incorporation or Articles of Association on a case-by-case basis, with primary consideration given to how they affect shareholders' long term interests.

3.1.2 Capitalization and issuance of shares

(Also see section 3.5.1 Unequal voting shares and dual classes of stock).

[The fund] recognizes that directors need the flexibility to issue stock to address a company's financial needs and conditions. However, it does not support giving directors unlimited discretion to increase the amount of stock issued without the consent of shareholders. The rules of the Toronto Stock Exchange currently allow companies to increase the amount of their stock by 20% without shareholder approval.

- [The fund] will vote against proposals to issue capital where the potential aggregate dilution is more than 20%, unless a sound business reason is given for issuing additional shares.

Outside of North America, companies commonly issue shares with pre-emptive rights, which allow shareholders to share proportionately in any new stock issuances of the same class.

- [The fund] will vote for share issuances with pre-emptive rights if the potential aggregate dilution is less than 50% and a sound business reason is given for the issuance. However, the fund may vote against these proposals if warranted by the frequency of the company's requests for additional shares and the reasons given for the requests.

3.1.3 Approval of financial reports and discharge of directors and auditors

Proposals to approve the company's financial reports and to discharge the directors and/or auditors from liability are routine matters at companies outside North America. However, some companies present the reports for which approval is sought only at the shareholders meeting, rather than sending them to shareholders before the meeting. As a result, shareholders who are not present at the meeting do not see the report they are being asked to approve. [The fund] finds this unacceptable.

- [The fund] will vote for proposals to approve financial or directors' reports only if the reports are provided to all shareholders before the shareholders meeting.

- [The fund] will vote against proposals to discharge auditors and/or directors from liability if there are concerns about the actions of either.

3.1.4 Votes to approve "other business"

Sometimes companies include the approval of "other business" as an item on the proxy ballot, without specifying what the "other business" consists of. [The fund] believes this constitutes giving the company broad discretion to act without specific shareholder approval on issues that would otherwise require such approval.

- [The fund] will vote against the approval of unspecified "other business".

3.1.5 Reports on corporate governance standards and practices

[The fund] believes disclosure helps to improve corporate governance. We will support proposals that ask corporations to report to shareholders on how well their corporate governance practices measure up to the guidelines established by a widely-accepted and authoritative set of corporate governance standards, such as the OECD Principles of Corporate Governance as their standard.

At a minimum, corporations should include a statement of their governance standards and practices in their annual report to shareholders, along with an evaluation of the effectiveness of their practices.

- [The fund] will vote for proposals that require companies to include in their annual reports a comparison of how well their corporate governance practices comply with a widely-accepted and authoritative set of corporate governance standards.

3.2 Boards of directors

3.2.1 Independent board of directors

Our guidelines concerning board independence (sections 3.2.1 and 3.2.1.1) are applicable only to companies that have a unitary board structure, also known as the Anglo-American model.

A company's management is responsible for running the company, and is accountable to the board of directors. The board of directors is responsible for overseeing management's performance in a way that ensures the long-term maintenance of shareholder value. The board is accountable to the shareholders as owners of the corporation.

Directors have a legal obligation to act in the best interests of the company. However, it is difficult for anyone to avoid being influenced by conflicts of interest. This is why boards of directors must be largely independent of the company's management. Directors are not in a good position to hold management accountable if they depend on the corporation for any benefit or consideration other than their stock in the company and the compensation they receive as directors.

For this reason, two-thirds of the board of directors should be independent, as defined below. At a minimum, there should be a majority of independent directors on a board.

- [The fund] will vote for proposals that require two-thirds of directors be independent.

- [The fund] will vote for proposals to make a majority of the directors independent in those cases where a board does not have a majority of independent directors.

- If a board does not have at least a majority of independent directors, [the fund] will withhold votes from those directors who are not independent. If it is not possible to vote on individual directors, [the fund] will vote against the entire slate of director candidates.

It is often difficult for shareholders to determine whether or not a director is independent. For this reason, [the fund] believes companies should disclose annually whether or not directors meet each of the criteria for independence given below.

- [The fund] will vote for proposals to require annual disclosure of whether or not directors meet each of the criteria for independence given below. It will also support other proposals to require annual disclosure of which directors are or are not independent and the basis on which the assessment was made.

3.2.1.1 Definition of an independent director

A director is deemed independent if he or she has no material relationship with the company, its chair, or employees, other than that of director and shareholder. This excludes directors with:

= Current or past employment by the corporation or an affiliate;
= Current employment with the company's current or former auditor, or previous employment within the past five years;
= Employment or family relationships with one of the company's paid advisors or consultants;
= Employment or family relationships with any of the company's attorneys or investment bankers.
= Interlocking directorships — that is, executives serve as directors on the boards of each others' companies;
= Family relationships between the director or nominee and the corporation's executive officers;
= Employment with one of the company's customers or suppliers;
= A significant interest in the company, or directors who represent a significant shareholder. This includes shareholders who control less than 50% of the company's voting power if they have business transactions with the company or a relationship to management;
= Indebtedness to the corporation or any subsidiary in an amount in excess of US$60,000 or CAD$100,000, except for bank executives with a residential mortgage at the same conditions and rates provided to customers;
= Employment with any foundation, university or other non-profit organization that receives grants, endowments, or other funding from the company;
= Relationships in which the corporation or any executive officer exercises significant control over an entity in which a director or immediate family member owns an equity interest or to which a director or immediate family member has extended credit. Significant control should be defined with reference to the contractual and governance arrangements between the corporation or executive officer, as the case may be, and the entity.
= The provision of any professional services, including legal, financial, advisory, or medical services by a director or immediate family member to any executive officer of the corporation in the last five years; or
= Any other relationship similar in scope and nature to the relationships listed above.

3.2.2 Independent chair of the board

The chair of the board of directors must be an independent director, as defined in guideline 3.2.1.1, in order to guide the board in its responsibility for overseeing management's performance. No one can fulfill the responsibilities of chair and those of a senior management position, such as Chief Executive Officer, without a conflict of interest. Former executives and executives of client or vendor companies also have potential conflicts of interest and should not serve as Chair.

- [The fund] will withhold votes from individual senior executives, executives of client or vendor companies, or other directors who are not independent, if they are also chair of the board or if, upon becoming director, they would become chair of the board.

- [The fund] will vote for proposals to require the chair of the board to be an independent director, as defined in guideline 3.2.1.1.

3.2.2.1 Independent lead directors

Some companies whose CEOs are also the Board Chair have sought to address concerns about the Chair's lack of independence by appointing an independent lead director. Some lead directors assume the full responsibilities and authority of the Board Chair, becoming Chair in everything except the title. But other lead directors take on only some of those responsibilities and powers. In those cases, the lead director position becomes fig leaf for obscuring the board's lack of independent leadership. It is extremely difficult for shareholders to know how much of the Chair's job a lead director has assumed, or what extent the person who still holds the title of Chair actually runs the board.

[The fund] believes that an independent lead director may be suitable as an interim step in separating the positions of Chair and CEO, but it is not a substitute for that separation. If a company chooses to appoint an independent lead director as an interim position, that person should serve as lead director for no longer than one year before an independent director is appointed.

- [The fund] will not withhold its vote from the Chair and CEO of a company if the board has a lead director who is independent (according to the definition in section 3.2.1.1 of these guidelines), as long as the position of lead director exists for no longer than one year.

- [The fund] will vote for proposals to create an independent lead director position, as long as the position exists for no longer than one year.

3.2.3 Key board committees

All boards of directors should have audit, compensation, corporate governance, and nominating committees. [The fund] calls these "key" committees because their functions are essential in overseeing a company. These committees are also in the best position to protect shareholder value and protect against corporate malfeasance. A recent study found that the independence of these committees is inversely related to allegations of corporate fraud.[2]

The corporate governance committee should have a majority of independent directors. The audit, compensation, and nominating committees should be made up entirely of independent directors.

3.2.3.1 Independent audit committee

Boards should have an audit committee responsible for oversight of the annual external audit of the corporation. This is recommended by the Toronto Stock Exchange and required by American securities regulations. All of the members of this committee should be independent directors as

[2] H. Azun, S. Szewczyk, R. Varma. "Board Composition and Corporate Fraud". *Financial Analysts Journal*, May/June 2004, pp. 33-43.

defined by guideline 3.2.1.1. The committee members should be free of ties to the company's auditor.

Members of the audit committee also need to be "financially literate". This is required by American securities regulations. Financial literacy is also necessary in order for the committee to oversee the complexities of the annual audit and deal with the technical aspects of financial information. [The fund] will support training for directors in this area.

The authority of this committee should be clearly laid out and should include the retention and remuneration of an outside auditor.

- [The fund] will vote for proposals to create audit committees in which all of the members are independent.

- [The fund] will withhold their votes from individual directors who are not independent and sit on the audit committee.

- [The fund] will vote for proposals to provide additional training in financial matters for directors.

3.2.3.2 Independent compensation committee

Every board should have a Compensation Committee that is responsible for the direction and oversight of the company's executive compensation program and for regularly evaluating the performance of senior management. In order to be effective and avoid conflicts of interest, this committee must be made up entirely of independent directors, as defined in guideline 3.2.1.1, and should not include directors who are CEOs of other companies. Members of this committee should not be nominated or selected by management.

Executive compensation is complex, and has been the subject of controversy recently; it needs to be designed and administered carefully. Directors on compensation committees should be knowledgeable in the field of executive compensation and should obtain training in this area if they are not. If the advice of a compensation consultant is sought, the committee should choose and retain the consultant, not the executives.

- [The fund] will vote for proposals to require boards to create compensation committees, and to require all members of those committees to be independent and not to be CEOs of other companies.

- [The fund] will withhold votes for individual directors who sit on the compensation committee and are not independent of management or are CEOs of other companies.

- [The fund] will vote for proposals to provide training in executive compensation for directors.

3.2.3.3 Corporate governance committee

A board of directors should have a corporate governance committee responsible for oversight of the governance of the corporation. This committee should be able to function independently of management. The committee should have at least a majority of independent directors and an independent chair; ideally, all of its members should be independent directors.

- [The fund] will vote for the creation of an independent corporate governance committee.

3.2.3.4 Independent nominating committee

Boards should have a nominating committee to identify the need for directors and to recruit, nominate, and orient new directors. The authority of this committee should be specified clearly.

In order for the board to function independently of management, the nominating committee must be made up entirely of independent directors, as defined by guideline 3.2.1.1.

- [The fund] will vote for proposals to create nominating committees made up entirely of independent directors. It will withhold votes from against directors who sit on the nominating committee and are not independent.

3.2.4 Shareholder nominations for director

Recent shareholder proposals have asked companies to allow shareholders to place candidates for director on the ballot, or make it easier for them to do so. In general, [the fund] supports giving shareholders the ability to nominate directors provided the nominees are well-qualified and are prepared to act in the interests of all shareholders. Shareholder nominations should be subject to a threshold for stock ownership of between 3% and 5% of ordinary shares. This threshold discourages frivolous nominations but still permits nominations by investors with smaller holdings.

Shareholders who nominate candidates for director should provide the same information about their candidates' qualifications, independence, and potential conflicts of interest as companies provide for their nominees. Nominations should be provided to the company in time to include candidate information in the company's proxy information circular, and on the proxy ballot.

- [The fund] will vote for proposals to allow shareholders to nominate directors if they are subject to an ownership threshold of 3% to 5% of ordinary shares, and provided the nominating shareholders provide adequate information to other shareholders about their candidates qualifications, independence, and potential conflicts of interest.

3.2.5 Voting for directors

(Also see sections 3.2.1 Independent board of directors and 3.2.3 Nominating committee).

- [The fund] will vote for directors on a case-by-case basis taking into consideration these guidelines and the long-term performance of the corporation and the directors. The following are reasons for [the fund] to vote against management's nominees:
  - The board of directors has consistently not responded to shareholder proposals approved by a majority vote;
  - The board of directors consistently acts in the interests of a group of shareholders, rather than in the interests of all shareholders;
  - An individual director has a conflict of interest; a conviction for financial, corporate, or securities crime, including insider trading; a history of serious misconduct, regulatory sanctions, or ethical violations relating to corporate responsibilities;
  - There is evidence that directors have purposely misstated or concealed the financial condition of the company; or
  - The board has regularly demonstrated a lack of duty of care, such as approving corporate restructurings that are not in the shareholders' best interests or refusing to provide information to which shareholders are entitled.

There are many other reasons [the fund] might vote against a nominee for director. Other factors to be considered in voting for directors are addressed in following sections.

Nominees for director are normally presented by management as a slate, and shareholders must vote for or against the entire slate, rather than voting for each director individually. However, the fund prefers to vote for each director nominee individually.

- [The fund] will vote for proposals to allow individual votes for each director nominee where this option does not exist.

3.2.5.1 Contested elections for directors

When there is a contested election for directors, the candidates not nominated by the board usually want to make a significant change in corporate policy. In deciding how to vote in contested elections, [the fund] will assess how any policy changes advocated by the opposing candidates will affect the long-term interests of shareholders. Alternative slates of directors will be given special consideration when the corporation's performance has been inferior to its peers for two years or more, there are reasonable doubts that the current board can improve the situation, and the opposing director nominees have the qualifications and a business plan to improve the corporation's performance.

- In contested elections, [the fund] will assess votes for directors on a case-by-case basis, using the criteria described above.

3.2.6 Term limits for directors

Directors must remain open to new ideas and be willing to critically re-examine the status quo, but also maintain continuity, and focus on the long term. Term limits for directors are used to increase the likelihood that the board remains open to new ideas and does not become entrenched in the status quo. However, term limits do not guarantee that directors will have this openness and can force valuable, experienced directors to leave the board solely because of length of service.

In general [the fund] does not favour term limits, because they impose an arbitrary limit on directors' tenure regardless of a director's performance, and because they tend to inhibit a long-term view of corporate affairs. However, there may be instances in which term limits are in the best long-term interests of shareholders, and [the fund] will support them in those cases.

- [The fund] will vote against term limits for directors, unless circumstances are such that they are in the long-term interests of shareholders.

3.2.7 Directors' ability to devote sufficient time and energy

Candidates for director must be able to devote a sufficient amount of time and energy to the board in order to oversee the corporation well. Indicators of a nominee's ability to devote sufficient time and energy to the board include the number of other boards the candidate serves on, other positions the candidate holds, and if the candidate is already a director, his or her attendance at board meetings in the past.

Although attendance at board meetings is not the sole determinant of a director's performance, poor attendance makes it difficult for a director to fulfill his or her responsibilities to the board. Since boards customarily schedule their routine meetings and committee meetings at least a year in advance, anyone who agrees to be nominated for director should be prepared to attend all board meetings.

- [The fund] will withhold votes for directors who appear to have too many existing commitments to fulfill their duties as director. Indications that a director has too many commitments could include serving on more than 5 other boards and/or employment as a senior officer at another company.

- [The fund] will withhold votes for existing directors if they have missed 25% or more of the board's meetings, including committee meetings, unless there are extenuating circumstances.

- [The fund] will vote for shareholder proposals to require companies to disclose directors' attendance at meetings.

3.2.8 Diversity on boards of directors

In order to foster the long-term success of corporations, boards should include directors with a wide variety of backgrounds and expertise, including women and people from various racial,

cultural and economic backgrounds.[3] Diversity on a board of directors is not mere tokenism. Women and visible minorities comprise more than half of the work force and own roughly a third of all small businesses in Canada. Women also make the majority of consumer buying decisions in North America. Several academic studies of corporate performance have found that companies with diverse boards of directors and senior executives are significantly more profitable than companies without this diversity.[4] The varieties of experience and perspectives on a diverse board of directors can give a corporation a distinct competitive advantage.

However, the fund does not support setting quotas for the number of women and people from a variety of racial, cultural and economic backgrounds to serve as directors. Quotas tend to focus attention on a nominee's ascribed characteristics, rather than his or her qualifications. In addition, quotas often become the maximum, rather than the minimum, number of people from under-represented groups serving on a board. For these reasons, [the fund] believes quotas are not an effective way to promote diversity on boards of directors.

- [The fund] will vote for proposals to promote greater diversity on boards of directors.

- [The fund] will vote against proposals to set a fixed number of women or people from diverse backgrounds as directors.

- [The fund] will vote for all well-qualified candidates unless doing so would violate another guideline.

3.2.9 Classified boards/staggered terms for directors

On a classified or staggered board, directors are elected for a term longer than one year and their terms are staggered so that only a portion of the directors come up for election each year. Typically, one third of the board is elected each year for a three-year term. On an unclassified or non-staggered board, all of the directors are elected annually.

[The fund] believes classified boards reduce corporate accountability to shareholders, and make it unnecessarily difficult to change control of a board.

- [The fund] will vote against proposals to adopt a classified board of directors.

- [The fund] will vote for proposals to eliminate classified boards and institute annual elections of all directors.

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[3] A majority of CEO's agree, according to a poll conducted in October 2001. *See*, Richard Blackwell, "More women needed on boards: CEOs" *Globe & Mail*, 30 October 2001. Internet edition.

[4] A study of 215 Fortune 500 companies over a 19-year period found that the companies with the best records of promoting women to top positions were significantly more profitable than the median Fortune 500 company in their industries. R. Adler, *Women in the Executive Suite Correlate to High Profits.* The Glass Ceiling Research Center. 2001. www.stanford.edu/~vskaran/Pics/LUMINA_GlassCeiling.doc; *Also see*, Elizabeth Church, "Market favours firms with women at top", *Globe & Mail*, 15 February 2001. p. B15.

3.2.10 Cumulative voting

Cumulative voting for directors is a process in which the number of votes each shareholder may cast is determined by multiplying the number of shares a shareholder owns by the number of directors to be elected. Shareholders may cast all of their votes for one candidate, or distribute them among any combination of candidates. This makes it easier for a minority of shareholders to elect director nominees of their choice to the board.

Cumulative voting enhances the power of minority shareholders to influence the board of directors. Experts on corporate governance disagree about whether or not this is in the best interests of most shareholders. Proponents of cumulative voting see it as a way to discipline directors, ensure minority shareholders a voice in corporate affairs and give the board some measure of independence from management. This can be especially important when board independence and minority representation are threatened by controlling shareholders, classified boards, and takeover defence measures.

Opponents of cumulative voting argue that it gives a minority of shareholders disproportionate control over the board, which violates fundamental principles of fairness and equity. A minority-controlled board may also be preoccupied with the agenda of a special interest group rather than the welfare of all shareholders, creating a tyranny of minorities and making it difficult for directors to work together.

In general, [the fund] is opposed to cumulative voting for directors except at companies where an individual shareholder or a small group of shareholders control the majority of the votes, such as companies with unequal voting shares or a controlling shareholder. In that case, cumulative voting is an acceptable way to protect the interests of minority shareholders.

- [The fund] will vote for cumulative voting only if the company has a controlling or dominant shareholder or shareholder group and the board has proven to be unresponsive to the interests of all shareholders, or if there are other indications that cumulative voting is in the best interests of shareholders.

3.2.11 Size of boards of directors

The number of directors on a board is a factor in the board's effectiveness. A board needs enough directors to maintain diversity in opinion and expertise, but not so many that the board becomes unwieldy, or that individual directors lose the opportunity to be heard. In general a good size for a board is between five and sixteen directors. However, the appropriate number of directors will vary with the size and nature of the corporation. In no case should a board have fewer than three directors. It is rare for a board to function well with more than 25.

Fixing the number of directors can limit the flexibility companies may need to alter the size of their boards as they change. Companies that need to add independent directors to their boards may also need this flexibility. However, fixing the number of directors also prevents management from changing the size of the board in order to maintain or enhance its control of

the board. Proposals to increase or decrease the number of directors will be given careful consideration.

- [The fund] will vote for proposals to fix the number of directors or to set minimum or maximum numbers of directors on a board, if the board has at least a majority of independent directors.

- [The fund] will vote against proposals to fix the number of directors less than 3, and or more than 25.

- [The fund] will vote against proposals to fix the number of directors if the board has less than a majority of independent directors.

- Proposals to change the number of directors on a board will be considered on a case-by-case basis, with particular attention given to the reasons for the change and the consequences for the long-term interests of shareholders.

3.2.12 Director indemnification

Directors are indemnified when the company pays the expenses of directors who become involved in litigation as a result of their actions as directors.

- [The fund] will vote for proposals to indemnify directors in cases where the company makes a persuasive argument that it is necessary to attract and retain directors, and for actions undertaken in good faith with a well-founded belief that the actions are lawful, or where litigation is unwarranted.

3.2.13 Director compensation and share ownership

Directors need to be compensated adequately for the time and work required to fulfill their responsibilities. However, they are in the awkward position of having to establish their own compensation. The potential conflicts this presents can be alleviated to some extent by requiring all compensation packages for directors to be fully disclosed and explained in the annual proxy circular and to be subject to shareholder approval.

Directors' compensation packages should not reward poor performance or provide greater compensation than the performance of the corporation warrants. If they do, [the fund] will vote against their approval.

- [The fund] will support proposals that require directors' compensation packages to be fully disclosed and explained in the annual proxy circular and to be subject to shareholder approval.

- [The fund] will vote against director compensation that is greater than the corporation's performance warrants.

Because the board of directors represents the shareholders of a corporation, directors should hold stock in the corporation in order to align their interests with shareholders' interests. However, requiring high levels of stock ownership without compensation in stock may preclude individuals who are well-qualified but not wealthy from becoming directors. Stock-based compensation for directors needs careful scrutiny to ensure that it aligns directors' interests with shareholders and not with management.

[The fund] prefers that directors not be granted stock options. Stock options tend to align the directors' interests with management rather than shareholders. However, we realize that there may be some cases where providing stock options to directors is in the best interests of shareholders, such as small, start-up companies that need to recruit well-qualified directors. In these cases, directors should not be included in the same stock option plan or compensation plan provided to management or employees of the company. If directors are included, the plan must prohibit discretionary awards of options for directors.

Plans to compensate directors with stock should not be structured to encourage short-term holdings, and are subject to the same concerns about appropriateness, dilution, and so forth, as stock option plans for management. (See section 3.3.5, Stock option plans). In all cases, director compensation must be structured in a way that will preserve the independence of the board of directors and promote the long-term interests of all shareholders.

- [The fund] will vote against granting stock options to directors, except in those cases where doing so is in the best interests of shareholders, as described above.

- [The fund] will vote against stock option plans that include directors in the same plan provided to management or employees of the company, unless the plan prohibits discretionary awards for directors.

- [The fund] will vote against any stock-based compensation plan whose structure encourages short-term holdings.

- Approval of directors' stock option plans will also be subject to the same limitations concerning dilution, repricing, etc. as stock option plans for management.

3.2.13.1 Retirement benefits for directors

[The fund] believes that in general retirement benefits are not appropriate for directors, because they increase directors' financial reliance on the corporation and may compromise directors' independence. If directors are also employed by the corporation, they may receive pensions for their employment, but not for their service as directors.

- [The fund] will vote against proposals to provide retirement benefits for directors.

3.2.14 Performance evaluations of directors and board

Boards of directors must evaluate their own performance, as a board, as committees, and as individual directors. This presents the same challenges and potential for conflicts of interest as designing directors' compensation. In order to evaluate themselves effectively, boards should adopt a written statement of governance principles as a benchmark for their own conduct. They should stay informed about developments in corporate governance and revise their statement of governance principles as needed to keep it current. They should also establish performance criteria for themselves and their committees and periodically review their own performances against those criteria.

It is the responsibility of the chair of the board to ensure that these evaluations are carried out on a regular basis. A summary of the board's collective evaluations should be included in the annual proxy information circular.

- [The fund] will support proposals to institute and develop performance evaluations for boards of directors.

- [The fund] will support proposals to include a summary of the board's collective performance evaluations in the annual proxy information circular.

3.2.15 Training for directors

The role of director is becoming more complex, and the field of corporate governance has rapidly expanded to include areas where directors often have little background. Even knowledgeable directors may find that they need additional training in order to guide the company effectively. [The fund] recommends that directors participate in training programs in order to improve their performance and the performance of the company.

- [The fund] will vote for proposals to provide training for directors.

3.2.16 Shareholder representatives on the board

Boards of directors should act on behalf of shareholders and should be shareholders themselves. Therefore, the inclusion of shareholder representatives on a board should be unnecessary - the directors should already be shareholder representatives. Calls for shareholder representatives may indicate that other changes on the board are needed, such as better communication between shareholders and the board, or the election of new directors. However, some forms of shareholder representation can be a useful part of corporate governance.

Shareholder advisory committees are usually established on an ad hoc basis to study and advise the directors on issues of concern to shareholders. These committees are helpful when their scope is limited to specific issues and does not include the day-to-day management of the company or duplicate the work of the board.

Longer term shareholder committees, also called “shadow boards”, are sometimes advocated as a way to add to the board’s expertise or increase the board’s responsiveness to shareholders. [The fund] prefers to meet boards’ need for expertise by electing directors with the background needed or providing additional training for directors. If directors are not responsive to shareholders’ concerns, better procedures for communicating between directors and shareholders may be needed. Directors who are consistently unresponsive to shareholders should be removed.

- [The fund] will support proposals for ad hoc shareholder advisory committees of boards of directors when needed to study a specific issue and advise the board.

- [The fund] will not support proposals for longer term “shadow boards” or shareholder representatives on boards of directors. However, if proposals for “shadow boards” or shareholder representatives are made, [the fund] will consider whether or not to give greater scrutiny to the board’s performance and to its communications with shareholders.

3.2.17 Auditor independence and the appointment of auditors

Auditor independence is vital to shareholders. A company’s annual financial statement is usually the only information shareholders have about the company’s performance and financial condition. They must be confident that they can rely on this information, and that the auditors who produced the information have not been compromised.

From time to time, companies hire their outside auditors as consultants or to provide other services. [The fund] believes this compromises the independence of those auditors. We strongly prefer auditors who have not performed other services for a corporation and do not hold contracts to perform services other than the annual audit.

- [The fund] will vote for proposals that prevent the outside auditor from doing any work for the company other than the annual audit, except in those cases where a company’s location, the nature of its business, or some other factor severely limits the number of accounting firms it can work with.

At a minimum, companies should disclose all of their relationships with their auditors and all fees paid to auditors for auditing and non-auditing services. [The fund] considers fees for tax services to be non-audit services. This disclosure is especially important in those cases where the company has made an exception to the independence provisions above.

- [The fund] will vote against auditors if more than half of the fees paid to them in the previous year were for services other than the annual audit, except in those circumstances mentioned above.

- [The fund] will vote against auditors if the company does not disclose the fees it paid its auditor for the annual audit, audit related services, and non-audit services in the previous year.

- [The fund] will vote for proposals to require companies to disclose the fees paid its auditor for the audit and for non-audit services.

3.2.17.1 Rotation of auditors

Companies that use the same accounting firm to conduct their audits for long periods of time run the risk of developing a close relationship that can compromise the independence of their annual audit. [The fund] prefers that companies rotate their audit firms every six to ten years. At a minimum, companies should change their audit partner every five years, regardless of whether or not they are required to do so by law.

- [The fund] will vote against auditors if the company has kept the same audit partner for more than five years.

- [The fund] will vote against the auditors if the company has kept the same accounting firm as its auditor for more than 10 years.

- [The fund] will vote for proposals that ask the company to change audit firms every five to ten years. [The fund] will assess proposals for a greater or lesser period on a case-by-case basis.

3.2.17.2 Certification of financial statements

American securities regulations require the chief executive officer (CEO) and chief financial officer (CFO) of a company to certify the accuracy of the company's financial statements. Canadian securities regulators are considering similar regulations. In the interim, shareholders in Canadian companies have submitted proposals asking their CEOs and CFOs to certify the companies' financial statements. [The fund] supports these proposals. Certifying that their financial statements are accurate makes CEOs and CFOs more accountable. It also gives shareholders a greater level of confidence in the financial statements they rely on to make investment decisions.

- [The fund] will vote for proposals that ask CEOs and CFOs to certify the accuracy of the company's financial statements where they are not required to do so by law.

3.3 Executive compensation

Executive compensation is a controversial area of corporate governance. Compensation must be attractive enough to draw, motivate, and keep qualified executives. However, executive compensation is widely perceived to be excessive. For example, in an editorial in the *Globe and Mail*, the chairman of Caldwell Securities wrote, "The genesis of many corporate failures and

longer-term underperformance likely lies in the absolutely insane levels of management compensation...”[5]

This rise in executive compensation when corporate performance is weak has caused concern among many shareholders. [The fund] does not intend to design executive compensation plans; this is the job of the independent compensation committees. However, in cases where we believe executive compensation has been consistently excessive, we may vote against the compensation committee or the entire board of directors. Furthermore, we intend to give executive compensation close scrutiny at all companies.

Executive compensation plans must also be consistent with long term interests of shareholders. These plans are usually complex, and must be tailored to the company, the industry, and often to the individual executive.

3.3.1 Executive compensation and performance

Executives are motivated to excel when their compensation is tied to their performance. As a general rule, executive compensation should be based on and reflect performance, rather than tenure or other criteria. Above-average pay should be reserved for above-average performance.

Clear, objective goals or standards for performance should be agreed on at the beginning of each evaluation period, and each executive’s performance should be measured against those goals at end of that period. These goals must be objectively tied to the company’s performance relative to other companies in the same industry and must be within the control or influence of the employee being evaluated. This excludes goals such as increases in stock price, which are not necessarily within the control of an individual employee and may occur for reasons that have nothing to do with the performance of employee or the company.

Executive performance should be evaluated by the board’s compensation committee, and when appropriate, with the assistance of an independent group of evaluators. If compensation consultants are used, they should be retained by the board, not by executives or candidates for executive positions.

- [The fund] will vote for executive compensation plans that it believes are fair, and oppose those it believes are excessive. Compensation plans are fair if:
    - They are linked to objective parameters of the company’s performance, such as earnings, return on capital, returns to shareholders, and other relevant measures. If stock prices are used as a parameter, they should be compared to the value of stock in the same industry or sector, rather than an absolute gain or decline in value;
    - They are affordable, given the company’s overall financial position;
    - They provide an incentive for excellent performance over the long term, and do not reward poor performance; and

[5] Thomas Caldwell. “Short-sighted self interest leads to corporate rot” *Globe and Mail*, 18 February 2002. p. B7; *Also see*, Louis Lavelle, Jessi Hempel, Diane Brady, "Executive Pay", *Business Week Online*. 19 April 2004. http://www.businessweek.com/@@IW@wtIYQ486HZRgA/magazine/content/04_16/b3879010.htm.

- The total compensation for each executive is understandable and reasonable compared to pay levels for comparable positions in the industry and compared to all pay levels within the company.

- [The fund] will vote against executive compensation plans that are not based on performance.

3.3.2 Executive performance and corporate social responsibility

[The fund] believes that long-term shareholder value is not measured entirely by annual financial statements. The value of a company includes such factors as the environmental sustainability of its practices, its employees' morale and safety, and the well-being of the communities in which it operates. These factors all contribute to a company's profitability in the long run. For this reason, [the fund] encourages directors to evaluate executives' contributions to the company's financial, environmental, and social performance.

- [The fund] will vote for proposals asking directors to link executive compensation to performance on social and environmental issues, as well as traditional measures of financial performance. Measures of executives' social and environmental performance should be reasonable, and within the executives' control.

For further discussion see section 4. Corporate Social Responsibility.

3.3.3 Executive salaries and employee wages

In 2003, the average compensation of the CEOs for the largest 50 companies in the Toronto Stock Exchange was 393 times the average Canadian family income.[6] This disparity between executives' and workers' salaries has been shown to lower job satisfaction, employee cooperation, and product quality, factors that affect shareholder value.[7]

Shareholder proposals addressing this issue have asked companies report on the gap between their highest and lowest paid employees, or to set a maximum range or ratio that they will allow between the highest and lowest paid employees. These proposals have become more common as concern grows among investors about excessive executive compensation.

[The fund] does not intend to design executive or employee compensation. However, it is not in the shareholders' best interests for the gap between executive and employee compensation to be so great that it hurts productivity and morale. Some management experts have suggested that an appropriate ratio of CEO compensation to average workers' wages is between 20 to 1 and 25 to 1. [The fund] encourages directors to consider these issues in designing executive compensation.

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[6] "50 top-Paid Executives" (table), *Report on Business Magazine Online*, Bell Globemedia Publishing Inc. http://www.globeinvestor.com/series/top1000/tables/executives/2004/; Statistics Canada, *Average market income by economic family types*, CANSIM Table 202-0202, catalogue no. 75-202-XIE. Last updated 2 September 2004.
[7] P. Singh and N. C. Agarwal, "Union Presence and Executive Compensation: An Exploratory Study" *Journal of Labor Research*, 23:631-636. 2002.

- [The fund] will vote for proposals that ask companies to report on the gap between their lowest and highest paid employees, provided the reports can be produced without undue expense or revealing confidential information.

- [The fund] will vote for proposals to establish a specific ratio between executive compensation and workers' compensation when the difference between the two is excessive, company performance is poor, and the board of directors has not addressed the issue.

3.3.4 Executive compensation during layoffs

Increasing the pay of management while laying off employees contradicts the principle that compensation should be linked to performance. If the company's performance is so poor that employees must be laid off, then the performance does not warrant an increase in executive compensation or benefits. [The fund] encourages directors to adhere to the principle of compensating executives based on their contribution to the company's performance.

- [The fund] will vote for proposals that require the company to halt any increase in executive compensation during layoffs, including freezing executives' salaries, restricting the exercise of stock options, and cancelling bonuses during layoffs.

3.3.5 Stock option plans

In principle, the inclusion of stock-based compensation in executive compensation plans benefits a company's shareholders. Stock-based compensation encourages executives to own stock in the company, thereby aligning their interests with shareholders.

However, stock options have been a common source of excessive executive compensation. One reason for this is that accounting practices have allowed companies to treat them as if they have no cost to the company. (See section 3.3.11, Disclosure of Executive Compensation, below). A second reason is that stock option awards may be based on the performance of the market as a whole, or on sector performance, rather than on the performance of the company. This undermines the principle of compensating executives for their performance.

Recent controversy surrounding stock options has led many companies to substitute other forms of compensation for options. However, stock options are still widely used, and abused. For this reason, stock option plans need particular attention in order to ensure that they harmonize managements' and shareholders' interests and do not provide excessive compensation to executives.

Although [the fund] does not intend to micromanage the administration of compensation plans, it also does not favour giving compensation committees broad discretion to set the terms of stock option plans. Instead, the board should submit a formula for the plan to shareholders for approval and rely on that formula in designing and administering the plan.

3.3.5.1 Price

Stock options should be issued at the fair market price of the stock at the time of issuance.

- [The fund] will vote against executive compensation plans that offer options at a price below the stock's market price.

3.3.5.2 Expiry

Stock options should expire within five years of the date they are awarded.

- [The fund] will oppose plans that have no expiry date or an expiry date longer than five years.

3.3.5.3 Dilution

Stock option plans dilute the earnings and voting strength of the company's shares. The level of acceptable dilution is relative to the size of the firm. Small companies may have a dilution rate of as much as 10%, but larger companies should have less dilution.

- [The fund] will oppose stock option plans in which the total dilution is more than 10%. Plans with dilution of more than 5% should meet at least one of the following criteria:
  - the plan is open to all employees, or a large proportion of them;
  - the company is a growth company;
  - the company is in a difficult financial situation;
  - the company's compensation policy is below competitive levels for the industry; or
  - the plan is consistent with competitive compensation levels in the industry.

There may be isolated instances in which a slightly higher dilution rate than 10% may in the best interests of shareholders; these will be determined on a case-by-case basis.

3.3.5.4 Grant rate

The grant rate, or "burn rate" of a plan is the percent of outstanding shares granted as options in a year. This rate should be no more than 1% of the company's outstanding shares. High grants rates are dilutive; grant rates above 1% warrant particular scrutiny of the plans' dilution.

- [The fund] will oppose plans with a grant rate of 2% or more. Plans that grant options above 1% will be given special scrutiny, especially if their dilution is also above 5%.

3.3.5.5 Repricing

When the market price of a stock is lower than the price offered in the stock option (so-called "underwater" options), companies sometimes change the price of the stock option to match the lower market price, or withdraw the option and reissue it after a delay at the lower rate. In either

case, this divides shareholders' and option holders' interests, since shareholders cannot reprice their shares. Some jurisdictions require companies to seek shareholder approval for repricing but others do not.

- [The fund] will vote against repricing of stock options, or the reissue of "underwater" options.

- [The fund] will vote against stock option plans that do not explicitly prohibit repricing or reissuing underwater options and the exchange of underwater options for other kinds of compensation, such as restricted stock.

- In general, [the fund] will vote against stock option plans if the company has repriced or replaced stock options without shareholder approval in the past three years. Exceptions will be made if the plan and the directors responsible for it have been replaced.

3.3.5.6 Vesting

Stock options granted to employees should have a minimum holding period before they can be exercised. Options are not effective tools for encouraging executives to manage for the long term when the options can be exercised as soon as they are granted. (Also see section 3.3.5.11, Change in Control Provisions, below, regarding accelerated vesting contingent on changes in control of the company.)

- [The fund] will vote against stock option plans that do not have a vesting period.

- [The fund] will vote for "performance-vesting', stock options i.e., stock options that vest as specific performance goals or standards are met.

3.3.5.7 Reload grants

A reload grant automatically gives the recipient additional stock options when the original options are exercised. The typical reload stock option is for the same amount of stock as the recipient has already purchased under the original option at the market price on the date the reload option is granted. The term of the grant may be the same as the original stock option, or it may be accelerated. Reloading options are dilutive. They also make it possible for the recipient to lock in increases in stock price with no attendant risk, a benefit not available to other shareholders.

- [The fund] will vote against stock option plans with reload option grants.

3.3.5.8 Automatic replenishment features, or "evergreen" plans

Stock options are granted from a pool of stock set aside for that purpose. The amount of stock in the pool is subject to shareholder approval. Normally, when that pool of stock is depleted, the company must seek shareholder approval to set aside additional stock for stock option grants.

However, stock option plans with automatic replenishment features automatically replace the stock available to be granted as options without prior shareholder approval.

The Toronto Stock Exchange rules allow companies to include automatic replenishment features in their stock option plans, provided they seek reapproval from shareholders every three years. However, [the fund] does not approve of plans with automatic replenishment features because they tend to be highly dilutive, and they provide only a limited mechanism for shareholders to stop increases in dilution should it become high enough to threaten shareholder value.

- [The fund] will vote against stock option plans that include an automatic replenishment feature.

3.3.5.9 Concentration of stock options

- In general, [the fund] will vote against plans that allocate 20% of the stock available for options in a given year to a single individual. This includes grants of “super options” with more restrictive vesting and performance provisions. Exceptions to this may be made for small companies that have few employees with stock options.

3.3.5.10 Change in control provisions

(See section 3.3.5.6 Vesting).

- [The fund] will vote against stock option plans with change-in-control provisions if they allow option holders to receive more for their options than shareholders receive for their shares. This includes accelerated vesting provisions.

- [The fund] will vote against change-in-control provisions that are developed in the midst of a takeover fight, and change-in-control options granted to directors.

- [The fund] will vote for proposals to require change-in-control transactions to be complete before any change-in-control provisions of stock option plans come into effect.

- [The fund] will vote for proposals that establish a "waiting period" between the time a change in control is complete and the implementation of any change-in-control provisions in a stock option plan. However, these proposal should not apply to stock-option recipients who are no longer employed by the company after the change in control.

3.3.5.11 Awards for consultants and contractors

Companies sometimes extend their executive stock option plans to their consultants or contractors. [The fund] is opposed to this practice. Stock options are intended to motivate employees to improve shareholder value over the long term. However, people whose work for the company is short-term have no reason to be motivated to improve long term shareholder value.

- [The fund] will vote against stock option plans that include consultants, contractors, or other temporary employees.

3.3.6 Restricted stock grants

Restricted stock is becoming a common replacement for stock options. Restricted stock plans award shares directly to recipients or allow the recipients to purchase the shares. The shares carry some restrictions — in particular, they cannot be sold — until after a vesting period, or until after certain performance criteria are met.

The purpose of restricted stock grants is to encourage recipients to hold stock in the company for an extended period, and to align their interests with shareholders'. This is based on the belief that owning shares over a longer period will encourage executives to manage the company with longer term interests in mind. Vesting periods for restricted stock should be at least three years; [the fund] prefers to see vesting periods of five years or more. If the restricted stock vests when certain performance criteria are met, the company should specify what the performance criteria are.

Unlike stock options, restricted stock retains some value even if the stock price falls. For this reason, grants of restricted stock are usually smaller than grants of stock options, (although there are some indications that executive restricted stock grants have begun to grow[8]) and thus less dilutive. However, they still have the potential for dilution. Dilution levels for restricted stock should not exceed 3%.

- [The fund] will vote against restricted stock awards that do not have a vesting period, or that vest in less than three years.

- [The fund] will vote against performance-vesting restricted stock awards if the performance criteria for vesting are not disclosed.

- [The fund] will vote against restricted stock plans if their overall dilution exceeds 3%.

3.3.7 Other kinds of stock awards

Alternatives to stock options and restricted stock awards include stock appreciation rights and phantom stock. Stock appreciation rights give recipients the difference between the exercise price and the market price of stock on the date of exercise. Stock appreciation rights do not involve the actual purchase or sale of stock. Phantom stock is similar in that it gives recipients bonuses for increases in the value of stock without requiring them to own any stock. Both kinds of awards do not cause any dilution and may discourage insider trading, but they do not encourage recipients to own stock in the company. They may also reward executives for increases in the price of the company's stock that are unrelated to the performance of the executives or the company.

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[8] Gordon T. Anderson, "The next outrage in CEO pay?" *CNN/Money* http://money.cnn.com/2003/04/23/pf/investing/CEOs_nextoutrage/index.htm. (accessed April 24, 2003).

- [The fund] will vote for alternative stock-based compensation only if the awards are based on the executive's performance and if the compensation plan effectively aligns executives' interests with shareholders.

3.3.8 Omnibus stock-based compensation plans

Omnibus stock-based compensation plans, which bundle more than three kinds of stock-based compensation into one plan, do not allow shareholders to vote on each component of the plan separately.

- [The fund] will vote against omnibus stock-based compensation plans.

3.3.9 Company loans for stock purchases

[The fund] opposes the practice of making loans to employees to allow them to purchase stock, even if the loans are made at market rates. This practice may leave the company with uncollectable debt and inhibit the termination of employees who have outstanding loans with the company.

- [The fund] will vote against compensation plans that provide for loans to make stock purchases.

- [The fund] will vote for proposals to prohibit companies from making loans to employees for stock purchases.

3.3.10 Changes in control (golden parachutes)

Golden parachutes are severance arrangements for executives and directors contingent on a change of control in a company. Golden parachutes are intended to ease managers' and directors' concerns about losing their jobs in the event of a successful takeover, and thus help them to make decisions in the best interests of the company and its shareholders. However, the amounts of compensation in these arrangements are often excessive, especially in light of the amounts of other compensation that executives typically receive.

- [The fund] will vote against golden parachutes, except in those cases where management can demonstrate that the arrangements are in the shareholders long term interest, do not create a conflict of interest for the recipients, and that the amounts involved are reasonable compared to similar benefits for all employees of the company.

- [The fund] will vote against any golden parachute that is not contingent on the completion of a change of control of the company, that is, a change in the ownership of more than 50% of the company's stock or voting rights.

3.3.10.1 Shareholder approval for executive severance compensation

- [The fund] will vote for proposals that require all severance packages for executives and directors be approved by shareholders.

3.3.11 Bonuses

Bonuses should be rewards for excellent performance. They become meaningless if given routinely or if they are given to employees whose performance is less than excellent. Employees, including executives, should be awarded bonuses when they exceed their performance goals or standards, but not otherwise. (See section 3.3.5 Executive performance and corporate social responsibility).

- [The fund] will vote against bonus plans that are not based on performance.

- [The fund] will vote against compensation plans that provide bonuses for average or poor performance. It will also vote against bonuses for executives whose performance is average or poor (that meets or is below goals), or where the company's performance has been average or poor.

- [The fund] will vote against bonus plans if the performance criteria are such that executives' bonuses are determined solely by increases or decreases in a company's share price. This includes bonuses that take the form of phantom stock or stock appreciation rights.

- [The fund] will vote against bonus plans if the company does not disclose the criteria on which bonuses are based. It will also vote against plans when the company's disclosure about the performance criteria is so vague that shareholders cannot determine what criteria are being used to award bonuses. An example would be a company that lists a large number of performance criteria they may use, with no indication of which criteria they would use in any particular circumstance.

- [The fund] will vote for bonuses, and compensation plans that provide them, for executives whose performance has been excellent.

3.3.11.1 Bonuses and restated financial reports

Recently, a number of companies have awarded bonuses to their executives based on financial results that later had to be restated. In other words, the companies' financial results - and the executives' performance - were not as good as originally stated.

In some of these cases, shareholders have filed proposals asking executives to pay back part of their bonuses to reflect the restated financial reports. [The fund] will support such proposals. We believe executives should not benefit from inaccurate accounting, and requiring repayment is a good incentive for management to be cautious about their financial reports.

- [The fund] will vote for proposals asking executives to pay back a portion of their bonuses when those bonuses are based on financial information that must later be restated.

3.3.12 Compensation caps

Compensation caps are a somewhat arbitrary way to control excessive executive compensation. In general, they violate the principle that employees should be rewarded for their performance, and they have the potential to make a company's compensation plan uncompetitive. However, there are instances in which they may be the best means available to rein in runaway executive compensation.

- [The fund] will assess proposals for compensation caps on a case-by-case basis. In general, it will vote against them unless executive compensation is excessive given the company's performance, and there is no other effective way to limit that compensation.

3.3.13 Disclosure of executive compensation

In order to vote wisely on compensation issues, shareholders must understand the company's executive compensation plan and philosophy. The company should describe its executive compensation plan clearly in its proxy circular including the rationale for salary levels, incentive payments and bonuses, stock-based compensation, severance arrangements, retirement benefits and any other contractual obligations of the company to named executives. [The fund] anticipates that this disclosure will go beyond what the company is required to disclose about its executive compensation.

- [The fund] will vote for proposals to require companies to disclose and fully explain its executive compensation plans to shareholders.

- [The fund] will vote for proposals that require companies to disclose the full cost of retirement benefits, severance packages, and all other contractual obligations they have to their named executives.

3.3.13.1 Expensing Stock Options

Accounting standards in Canada and the United States may soon require companies to include the value and cost of stock options in their statements of earnings. Recent shareholder proposals have asked companies to include the cost of stock options in their earnings statements, and some companies have begun to do this voluntarily.

[The fund] supports this trend. In order to accurately reflect the full cost of executive compensation packages, the value of all stock-based compensation should be included in company's earnings statements, regardless of whether or not this is required by accounting standards.

- [The fund] will vote for proposals to include the value of all stock-based compensation in statements of earnings.

3.4 Takeovers

Shareholders must be vigilant about protecting their interests concerning takeovers. Although takeovers may pay a premium to shareholders, they may also involve efforts to depress the price of the stock, or they may damage the company's long-term profitability. Measures designed to protect companies from takeovers often protect a company's directors and management regardless whether or not the takeover is in the shareholders' interests. Takeovers and takeover defences require special scrutiny to be sure that shareholders' long term interests are protected.

3.4.1 Shareholder rights plans or "poison pills"

Shareholder rights plans, which are also called "poison pills", involve issuing stock purchase rights. These rights cannot be exercised unless a takeover offer is tendered or a potential acquirer of the company purchases a specified percentage of the shares. If the company cannot negotiate a takeover arrangement with the acquirer, the rights allow shareholders other than the potential acquirer to buy additional shares at very favourable prices. This makes the takeover much more expensive for the potential acquirer.

Shareholder rights plans are intended to push potential buyers of the company to negotiate with a company's board of directors, since they may avoid triggering the plan by doing so. Shareholder rights plans have two legitimate purposes. They can ensure that all shareholders are treated equally in a takeover, and they can give the board time to negotiate a better deal with the acquirer or solicit and consider other, competing bids that would maximize the value of the company's shares.

However, shareholder rights plans also have drawbacks for shareholders. They commonly thwart takeover attempts, including those that would benefit shareholders. Also, they often cause the price of the company's stock to drop significantly. And like other takeover defences, shareholder rights plans tend to protect the directors and management rather than promoting the best interests of shareholders. Plans must be designed to protect shareholder value, rather than to protect the board and management.

In Canada, companies must submit shareholder rights plans to a vote by shareholders within six months of adopting them. In the US, boards can adopt poison pill plans without shareholder approval or participation. [The fund] believes all shareholder rights plans should be submitted to shareholders for their approval, regardless of whether or not this is required by law.

- If poison pills are adopted without shareholder approval, [the fund] will withhold votes for the directors who adopted it. (See section 3.2.4 Voting for directors).

- When poison pill plans are submitted for shareholder approval, [the fund] will assess them on a case-by-case basis. It will vote for them only when the plan ensures that

shareholders will receive a fair price for their stock in a takeover, and the plan will not protect management or the board at the expense of the shareholders' interests. Specifically, [the fund] will vote for a plan only if:

- The threshold for triggering the poison pill is no less than 20% of the company's shares. The definition of "acquiring person" should exclude anyone who strays across this threshold without intending to take over the company, such as passive institutional investors;
- The plan's definition of beneficial ownership does not include references to voting agreements or dispositive power, because these can interfere with the legitimate corporate governance activities of institutional investors;
- The plan allows a "permitted bid" - that is, a bid to acquire the company that does not trigger the shareholder rights plan - to go directly to the shareholders for a vote. The board should not be able to refuse to allow the bid;
- Partial bids are permitted with a minimum deposit requirement;
- The permitted bid stands for a maximum of 60 days, in which time the board must either announce an alternative bid or allow the permitted bid to go to the shareholders. Many plans set 60 days as the *minimum* period of time for a bid to stand. [T]he fund believes 60 days is long enough for directors to solicit other offers for the company, and that periods longer than this discourage takeovers.
- Potential acquirers should be able to continue purchasing the stock in accordance with applicable regulations during the 60 day permitted bid period;
- If the board wants to waive or redeem the plan in order to allow the company to be acquired by means other than a takeover bid, the shareholders' prior approval should be required;
- The board can waive the plan to allow a non-permitted takeover bid to be made by sending a takeover bid circular to all shareholders, as long as this waiver is extended to any other contemporaneous bids. In this case, all takeover bids must be made by sending a takeover bid circular to all shareholders before the expiry of the initial bid.
- Rights can be redeemed only with shareholders' ratification;
- Private placements are not exempted from the plan;
- "Soft" lock-up agreements, in which shareholders can break the agreement to sell their shares to a competing offeror, are exempted from the plan;
- Break fees, if any, should not exceed 2.5% of the price payable under a lock-up bid;
- The terms "beneficial ownership" and "acting jointly or in concert" should be based on ownership of shares at law or in equity, not voting rights or agreements;
- The offer will be considered approved if a majority of the votes cast by independent shareholders at a shareholders' meeting are in favour;
- The potential acquirer has the right to amend the offer before the shareholders' meeting;
- The plan will be resubmitted to shareholders for approval every three years; and
- Any amendments to the plan will be submitted to shareholders for approval.

3.4.2 Crown jewels

In a crown jewel defence against a takeover, the target company sells its assets to a friendly third party to prevent a potential acquirer from buying them. In Canada, crown jewels defences

usually require the approval of shareholders. Shareholders can also seek the fair value of their shares from the potential acquirer if substantially all of the target company's assets are included or if the takeover would change the essential nature of the company's business. This is often referred to as the "appraisal remedy".

Crown jewel transactions are often made on very short notice, giving shareholders very little time to consider how the transaction will affect the value of their shares or control of the company.

- [The fund] will vote against crown jewel transactions unless the company can show clearly that the shareholders' interests will be protected.

3.4.3 Leveraged buy-outs and "going private" transactions

In a leveraged buyout a group of buyers — often the company's management or controlling shareholders — borrows money to purchase a controlling interest in the company. A "going private" transaction is one in which the buyer will turn the company into a privately-held one. The issue of concern in both kinds of transactions is whether or not the price offered to shareholders is fair. The outstanding shares may be priced at less than they are really worth, especially if no other potential buyer has had an opportunity to make a competing bid. Management and controlling shareholders usually have more information than shareholders about the company's prospects, and thus its value. Without competing bids for the company, it can be difficult for shareholders to know whether or not the offer is fair.

- [The fund] will vote against leveraged buyouts and "going private" transactions unless competing buyers have had an opportunity to bid on the company, and the transaction gives shareholders the best value available.

- [The fund] will vote against directors who have supported leveraged buyouts that were not in the best interests of shareholders. (See section 3.2.4 Voting for directors).

3.4.4 Lock-up agreements

Lock-up agreements are private agreements made by a small group of shareholders to sell their shares to another company or third party that intends to make a takeover bid. No other bids for the shares are allowed, and the offer is not made to other shareholders. Prospective acquirers use lock-up agreements to try to "lock in" a price for the company by purchasing a minimum number of shares at that price. No appraisal remedy or shareholder vote is required for lock-up agreements, because the sale of shares is private and voluntary.

All shareholders have the right to sell their shares as they see fit. However, a lock-up agreement does not serve the interests of all shareholders if it prevents them from getting the best value for their shares in the transaction. In most cases, the best value can only be known if the company solicits and responds to competing offers for its purchase.

Unfortunately, dissenting shareholders can do little to protest a lock-up agreement, because the agreements are private.

- [The fund] will vote against proposals to allow management to enter into lock-up agreements without entertaining competing bids for the company, or if the agreement triggers a poison pill.

3.4.5 Private and targeted share placements

A company's management or directors may protect themselves from a takeover by placing a large block of shares in a "safe place", such as their employee stock option plan or with a sympathetic firm or individual shareholder, so that those shares cannot be purchased. Private and targeted share placements do not benefit shareholders if they result in dilution, or if the takeover would be in the best interests of shareholders.

- [The fund] will vote for proposals to require companies to seek shareholder approval before making any targeted or private share placements that involve more than 5% of the existing shares.

- [The fund] will vote for private or targeted share placements if they are negotiated at arms length and are based on the fair market value of the stock.

3.4.6 Opting out of takeover laws (US)

In the United States, some states have laws that protect corporations from hostile takeovers, with provisions that allow corporations to opt-out of these protections. In general, [the fund] does not support these laws, because they prohibit prospective buyers from making well-financed bids for a company and providing a benefit to shareholders. These laws may also limit directors' fiduciary obligations to shareholders.

- [The fund] will vote for proposals to opt out of takeover protection laws.

3.4.7 Reincorporation

(Also see section 4.2.4 Reincorporation in off-shore tax havens).

Companies may reincorporate in a different jurisdiction for sound business reasons, but also as a takeover defence or as a way to limit the directors' liability. [The fund] will assess these votes individually.

- [The fund] will vote for reincorporation proposals when management can demonstrate that there are sound financial or business reasons for the move.

- [The fund] will vote against reincorporation as a takeover defence or to limit director liability.

3.4.8 Miscellaneous takeover defences

When a company proposes or invokes other takeover defences not listed here, those defences should be evaluated on a case-by-case basis to determine what the overall benefits of the proposal are to shareholders in the long term. Do the takeover defences entrench management at shareholders' expense? Do they protect the company and its employees from corporate raiders who are not concerned with the company's long-term growth and profitability? Would a takeover improve the company's performance or worsen it?

- [The fund] will assess votes on other takeover defences individually, based on how they will affect shareholder value in the long term.

3.4.9 Consideration of the effects of mergers, takeovers and acquisitions

The shareholders of some companies have proposed requiring directors to consider the effects of mergers, takeovers, or acquisitions on employees, suppliers, the surrounding communities, and other "stakeholders". [The fund] believes that these proposals can enhance long-term shareholder value. An evaluation of the broader effects of mergers, takeovers, or acquisitions may reveal hidden costs, such as reduced productivity due to job losses or responsibility for environmental damage.

- [The fund] will vote for proposals requiring directors to consider the effects of mergers, takeovers, or acquisitions on employees, suppliers, the surrounding communities, and other "stakeholders".

3.4.10 Shareholder approval of takeovers and mergers

Any action that alters the relationship between shareholders and the board, or that result in major changes in the structure or control of the corporation should be submitted to the shareholders for a vote. This includes takeovers, takeover defences, mergers, and acquisitions. Shareholders should be given adequate information and time to make informed, well-considered decisions about these issues.

- [The fund] will support proposals that require directors to submit to shareholders any changes in the structure or control of the corporation, or in the relationship between shareholders and the board.

3.5 Protection of shareholder rights and interests

3.5.1 Unequal voting shares and dual classes of stock

Common stock traditionally carries one vote per share. Companies with dual class share structures have a class or classes of stock with more votes per share than their common stock. Dual class share structures allow some shareholders to maintain control of the corporation without holding an equivalent amount of equity. .

[The fund] is opposed to dual class share structures for several reasons. First, they violate the principle of one share, one vote, making it possible for the company to act without the support of a true majority of shareholders. Second, when dual classes of stock are initiated, they are likely to dilute the voting power of shares already issued. Third, it is not in the best interests of the majority of shareholders for a few investors to control the corporation without a comparable financial stake in the company.

- [The fund] will vote against the creation or issuance of shares that do not have full voting rights.

- [The fund] will vote for the replacement of dual class shares with shares carrying one vote per share, unless circumstances make this contrary to the long term interests of the majority of shareholders.

- For companies where a dual class structure is already established, [the fund] will vote for proposals for a mandatory review of the stock structure and regular reapproval by shareholders.

3.5.2 Supermajority approval of transactions

Supermajority requirements require the vote of more than a simple majority — usually 2/3rds of the vote — to approve a decision or transaction. [The fund] believes supermajority requirements have a legitimate purpose but are also subject to misuse. It will vote to support or approve supermajority requirements on a case-by-case basis.

Companies sometimes require supermajority approval to change their by-laws or provisions of their charters, to ensure that there is broad agreement on such fundamental changes in the corporation. [The fund] believes this is a legitimate use of supermajority requirements. However, supermajorities are also used by management to fend off hostile takeovers, or to secure their own control of the corporation.

- [The fund] will vote for supermajority provisions for changes to company by-laws or charters if the majority required is no more than 67% of the vote.

- [The fund] will vote against supermajority requirements if they apply to votes on any other issues.

- [The fund] will vote against any supermajority provision that requires more than 67% of the vote in favour of a decision.

3.5.3 Greenmail

A company pays “greenmail” when it buys the stock of a would-be acquirer at a price above the market price of the shares, usually in exchange for the would-be acquirer’s agreement to end the takeover attempt.

Provincial securities laws do not permit greenmail payments in Canada. However, they do occur in the United States. Greenmail is unfair to the shareholders who do not get the preferred price for their stock. Studies by the US Securities and Exchange Commission also show that greenmail payments devalue a company's stock, which further hurts shareholders. And greenmail denies shareholders the opportunity to decide whether or not the prospective takeover is in their best interests.

- [The fund] will vote for anti-greenmail proposals.

- If shareholders have the opportunity to vote on a greenmail payment, [the fund] will vote against it.

- If greenmail is paid and no vote is offered on the greenmail payment, [the fund] will vote against the directors who approved it at the first opportunity. (See section 3.2.4 Voting for directors).

3.5.4 Linked proposals

Linked proposals combine two or more issues into a single proposal, which is presented to shareholders for a yes-or-no vote. These proposals typically combine an issue shareholders are likely to support with one they are unlikely to support, in order to get shareholders' approval for proposals they would not approve otherwise.

- [The fund] will vote against linked proposals unless all of the issues in the proposal benefit shareholders in the long term.

- [The fund] will vote for proposals to prohibit the use of linked proposals.

3.5.5 "Blank cheque" preferred share issues

"Blank cheque" preferred shares give the board of directors broad discretion to determine the voting, dividend, conversion, and other rights of these shares. The board may also have discretion to determine the number of preferred shares to be issued. These shares carry a fixed dividend and are better secured by company assets than common shares.

[The fund] opposes the issuance of "blank cheque" preferred stock because this stock gives directors complete discretion over the conditions of the stock, and because it can be used to thwart takeover bids without presenting the bid to shareholders. If directors can determine the number of shares to be issued, the issuance of blank cheque preferred stock can also be excessively dilutive.

- [The fund] will vote against the authorization of blank cheque preferred stock.

3.5.6 Fair price proposals

Fair price proposals require a bidder to pay the same price for all of the company's shares purchased, usually the highest price paid by the bidder for any shares acquired before the start of the tender offer. These proposals defend against two-tiered offers, in which a higher price is paid in the initial offer (often to make a takeover bid attractive to shareholders), but a lower price is offered for the remaining shares. Two-tiered offers are effectively prohibited in Canada, but are made in other jurisdictions.

- [The fund] will vote for fair price proposals.

3.5.7 Dividends

[The fund] favours the regular payment of dividends and dividend increases, because they provide a return to shareholders. Studies have shown that the initiation of dividends correlates with market overperformance.

- [The fund] will vote for declarations of dividends.

3.5.8 Share buybacks or repurchases

Share buybacks can benefit shareholders, but only under certain conditions. Share buybacks near or below book value benefit shareholders. But when stock market values are high, they provide less benefit to shareholders. They also tend to inflate the value of stock options making executive compensation more expensive to the company. If surplus cash is used to buy back shares, it can add to the volatility of the share price. Finally, share buybacks can destabilize pension fund reserves.

- [The fund] will assess share buybacks on a case-by-case basis for their effect on shareholders' interests, especially if there is no accompanying increase in the regular dividend.

3.5.9 Confidential voting

Proxy voting typically is not done by secret ballot. This allows management to contact dissenting voters and urge them to change their votes. [The fund] believes the proxy voting process should be confidential, impartial, and free from coercion. It supports proposals to institute confidential voting. This includes making all votes by proxy, consents and authorizations secret, concealing the identity of all voting shareholders except to the extent necessary to comply with any legal requirements, and withholding proxies or other voting documents from examination except by independent election inspectors and tabulators.

- [The fund] will vote for proposals to institute confidential proxy voting.

- [The fund] will vote for proposals calling for independent vote tabulators and inspectors of elections to guarantee confidentiality and impartiality in proxy voting.

3.5.10 Quorum requirements

The quorum for a shareholders' meeting is determined by the percentage of total voting shares represented either in person or by proxy. The Canadian Business Corporations Act allows companies to call a quorum with as little as ten percent of the voting shares represented. [The fund] believes this level is too low. It allows companies to make decisions that require shareholder approval without consent from the owners of 90% of the shares.

The appropriate quorum size for a company depends on the size of the company. For large corporations, such as those with CAD$100 million or more in assets, at least twenty-five percent of the voting shares of a company should be represented at a shareholders' meeting in order for a quorum to be considered present. Companies that are smaller may require proportionally less than 25% of their voting shares for a quorum. However, only very small companies (e.g. assets under CAD$ 5 million) should consider 10% of their voting shares to be enough for a quorum.

- [The fund] will vote on proposals to set the percentage of voting shares required for a quorum at shareholder meetings on a case-by-case basis, depending on the size of the company.

- [The fund] will vote for proposals to set the requirement for a quorum at no less than 25% of voting shares.

3.5.11 Shareholder-called meetings

Shareholders have a fundamental right to call special meetings, and this right should not be eliminated or abridged without the approval of the shareholders.

- [The fund] will vote against proposals to limit or deny shareholders' rights to call special meetings.

3.5.12 Shareholder proposals

Shareholders have a right to bring proposals to the annual meeting, subject to applicable laws. These proposals should be included on the proxy ballot, and proponents should be given adequate space in the proxy circular to explain the proposal. The board should implement any shareholder proposal that is approved by a majority of the shareholder votes cast.

- [The fund] will vote against directors who fail to implement shareholder proposals that win majority approval. (See section 3.2.4 Voting for directors).

3.5.13 Shareholder action by written consent

Shareholders have the right, without calling a meeting, to solicit votes for a proposal and to act on the proposal if it passes and if the majority give their written consent.

- [The fund] will vote against proposals to limit or deny shareholders' rights to take action by written consent.

3.5.14 Shareholders' meetings

Participation in shareholder meetings is a basic right of shareholders. Companies should encourage shareholder attendance at the annual general meetings. They can do this by making shareholders' expense and convenience primary considerations in deciding when and where to hold the annual meetings.

Recently, some companies have sought authorization to hold their shareholders' meetings entirely by electronic means, without any shareholders being physically present. Technology such as teleconferencing can supplement shareholders' meetings by making it easier for shareholders to observe the proceedings. However [the fund] believes that meetings held entirely by electronic means, without the opportunity for shareholders to attend in person, could inhibit shareholder participation and are not an adequate substitute for meetings in which shareholders can be physically present.

- [The fund] will vote against proposals to hold shareholders' meetings entirely by electronic means.

3.5.15 Shareholder access to proxy information

All shareholders should be given timely and sufficient information about the date, location, and agenda of shareholder meetings, and about the issues to be decided at the meetings. All shareholders should have access to proxies and adequate time in which to consider the issues and vote on them. All votes should be given equal weight.

3.6 Other corporate governance issues

3.6.1 Profit-sharing and employee stock ownership plans

Employee stock ownership plans and other profit-sharing programs promote employee participation and create an additional incentive for good performance. Employee stock ownership plans differ from executive stock-based compensation in that they are open to all or the vast majority of a company's employees. Most of these plans offer employees the opportunity to purchase stock or stock options at a discount. They are subject to the same concerns about dilution as other stock option plans. Discounts on the option or stock prices should be no more than 15%.

- [The fund] will vote in favour of employee stock ownership and profit-sharing plans, provided they discount options or stock by no more than 15%, and conform to other relevant sections of these guidelines, such as dilution and loans for share purchases.

4. CORPORATE SOCIAL RESPONSIBILITY

Corporate social responsibility is closely related to corporate governance in that it involves oversight of the corporation's relationship with the society and natural environment in which it operates.

As a practical matter, proxy votes on social responsibility issues differ from those on corporate governance issues in several key ways. First, they are almost always on shareholder proposals, rather than proposals from management. Second, the range of possible issues within corporate social responsibility is vast — certainly much larger than the range of topics covered by corporate governance. This makes it virtually impossible to anticipate and devise a guideline for all of the possible social responsibility proposals that could be presented in a given proxy season. These guidelines address this problem by identifying a set of internationally accepted standards and norms against which to assess corporate social responsibility proposals, augmented by specific guidelines for common types of proposals.

Social responsibility issues also differ from corporate governance issues in that corporate managers, boards of directors, and investors sometimes believe that attention to the social and environmental aspects of company operations will limit companies' profitability, and thus conflicts with their duties as fiduciaries or business managers. This belief is grounded in the shareholder primacy view of business, which has been widely accepted in business management for at least the past century. This view holds that the only social responsibility of business is the maximization of profits, along with adherence to normal business ethics. According to this position, fiduciaries and business managers must put the financial interests of their beneficiaries or shareholders ahead of any social or political agenda, no matter how good the cause may be.

[The fund] takes a different view of corporate social responsibility and of shareholder interests. Acting in a socially and environmentally responsible way is not detrimental to the profitability of companies or to the interests of their shareholders. In fact, social responsibility is necessary for sustained profitability and long-term shareholder benefit.[9] In order to succeed, businesses need to treat employees, suppliers and customers well, to be environmentally responsible, and to be responsive to the interests of the communities in which they operate. These considerations may provide reasons to exceed the minimum requirements set by law.

Pension fund fiduciaries must also keep in mind their funds' long-term commitment to provide pension benefits many decades into the future, and exercise their proxy voting rights in a way that will maintain the social, economic, and environmental structures upon which long-term investment returns are based.

In addition, [the fund] is mindful of its social responsibility as an institutional investor, which obliges it to consider the consequences of its own investment decisions on society and the

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[9] S. L. Hart, C. M. Christensen. "The Great Leap" *MIT Sloan Management Review* 44(1):51-57, 2002; M. Barnett, R. Saloman, "Unpacking Social Responsibility: The Curvilinear Relationship Between Social and Financial Performance" *Academy of Management Proceedings*. 2002 pp. B1-B6.

environment. As pension funds have grown and become a larger part of equities markets, their social responsibilities have increased accordingly.

4.1 General guidelines

4.1.1 International standards and norms

When evaluating proxy issues on corporate social responsibility, international law and agreements provide useful standards for socially responsible business practices. [The fund] will be guided in its proxy voting by the principles concerning the fair treatment of workers, environmental protection, and economic development at the local level that are expressed in the following international agreements. All of these agreements have the support of the Canadian government.

- The Universal Declaration of Human Rights (http://www.un.org/Overview/rights.html)
- The Geneva Conventions http://www.icrc.org/ihl.nsf/WebCONVFULL?OpenView
- The International Labour Organization Fundamental Principles and Rights at Work http://www.ilo.org/public/english/standards/index.htm
- The International Labour Organization Tripartite Declaration of Principles on Multinational Enterprises and Social Policy (http://www.ilo.org/public/english/employment/multi/forum.htm)
- The Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprise (http://www.oecd.org/document/28/0,2340,en_2649_201185_2397532_1_1_1_1,00.html)

It will also be guided by the principles of the following international standards:

- The United Nations Global Compact (http://www.unglobalcompact.org/Portal/)
- The Global Reporting Initiative Standards (http://www.globalreporting.org/)

The primary responsibility for determining what a company should do to be socially responsible rests with management. However, when a company's actions violate international standards and/or expose shareholders to increased liability or financial risk without fair disclosure or reasonable mitigation, fiduciaries have a responsibility to take steps to protect the value of their investments.

- In general, [the fund] will vote for shareholder proposals that call on companies to adhere to principles established in these international agreements, unless doing so would weaken a company's existing social responsibility standards.

- [The fund] will vote for proposals to endorse the United Nations Global Compact, unless doing so would weaken a company's existing social responsibility standards.

4.1.2 Accountability and transparency

Corporations have a responsibility to disclose to their shareholders the social and environmental risks and potential liabilities of their operations. This information should be disclosed in the normal course of reporting to shareholders. In addition, [the fund] recommends that companies work with key stakeholders to develop annual reporting formats that are complete, accurate, and independently verified.

[The fund] recommends that companies use the Global Reporting Initiative standards as a model for this disclosure. The Global Reporting Initiative (GRI) is an international non-governmental organization affiliated with the United Nations that includes businesses, accountants, and non-governmental organizations. It was formed to create uniform reporting standards for the economic, environmental, and social performance of businesses and other organizations. We recommend the GRI reporting standards because they are clear and easy to follow, the GRI provides assistance in implementing the standards, and it solicits feedback for improvements from businesses that use its standards.[10]

- [The fund] will vote for proposals to provide shareholders with information related to social and environmental operations, including risks and liabilities, provided the information is not already available and readily accessible to shareholders, and the costs of providing the information are reasonable. Disclosure of this information should not require revealing confidential or proprietary information.

- [The fund] will vote for proposals calling for companies to report to shareholders using the Global Reporting Initiative standards.

4.2 Labour rights

The International Labour Organization's Fundamental Principles and Rights at Work spells out certain basic labour rights; these are described in more detail in section 4.5.1 on overseas labour practices. [The fund] encourages companies to adopt the ILO Fundamental Principles and Rights at Work as a minimum commitment to labour rights in all of their operations.

4.2.1 Workplace practices

In general, companies that treat their employees as partners and recognise their employees' knowledge and experience as a form of capital are more profitable. Companies that lay off workers in an effort to improve short term stock prices, have large disparities in pay, a general lack of job security, or whose employees believe they are powerless in the workplace have lower productivity, higher turnover, and a diminished performance overall. Employers who provide employee training, involvement in decision-making, compensation linked to performance, employment security, and a supportive work environment are more likely to enjoy improved

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[10] Global Reporting Initiative. *Sustainability Reporting Guidelines on Environmental, Economic and Social Performance*. *http://www.globalreporting.org*. June 2000.

productivity and long-term financial gain.[11] [The fund] encourages companies to adopt such policies because they contribute to the long-term profitability of companies, and consequently benefit shareholders.

- [The fund] will vote for proposals that ask companies to report on the quality of their workplace practices and on their efforts to improve the quality of their workplaces.

4.2.2 Layoffs and reductions in force

One aspect of treating employees as partners is avoiding layoffs except as a last resort. Layoffs can damage a company's reputation, employee morale, and community relations, and may not be in the best long-term interests of shareholders.

[The fund] recognizes that layoffs may be unavoidable under some circumstances. However, some layoffs are initiated because of the perception that they are a quick way to cut costs and boost profits. Research conducted since the mid-1990's has shown that companies that use this strategy hurt their profits in the longer term. Companies that downsize have been found to perform slightly better than stock market indices in the six months following the announcement of downsizing, but lag behind after that. In one study, the stock prices of companies that downsized dropped by an average of 24% three years after the layoffs.[12]

Shareholder proposals on this issue usually ask companies to report on how they will respect workers' rights during downsizing, and to give employees and communities adequate notice of layoffs or facility closures.

- [The fund] will assess shareholder proposals concerning layoffs on a case-by-case basis. This assessment will include consideration of the likely consequences of any proposal for the employees, local communities, and the long-term profitability of the company.

4.2.2.1 Programs for laid-off workers

Plant closings and layoffs can have a detrimental effect on local economies, especially in small communities where a plant closing may affect a large proportion of the community's population. Proposals have asked companies to provide or expand programmes to assist employees displaced by plant closings, or to work with government programmes to assist these employees.

- [The fund] will vote for proposals to implement programmes to assist laid-off workers provided the costs of the programmes are reasonable.

[11] Gil A. Preuss. "High Performance Work Systems and Organizational Outcomes: The Mediating Role of Information Quality" *Industrial and Labor Relations Review* 56(4):590-606. 2003; Ned Hamson. "Organizing for High Performance" *Journal for Quality and Participation* 24(4):14-20. 2001.
[12] Jim Clemmer. "Wise managers treat layoffs as last resort" *Globe and Mail*, March 4, 2002. p. C1

4.2.3 Discrimination in employment

All jurisdictions in Canada and the US have laws prohibiting discrimination in employment on the basis of race, religion, national origin, ancestry, sex, age, and physical disability. Many jurisdictions also have laws prohibiting employment discrimination on the basis of sexual orientation and promoting pay equity and affirmative action. Shareholder proposals in this area typically include requests for reports on diversity in the workplace, and the adoption of specific employment programs, policies, or goals.

[The fund] encourages companies to make all employment decisions on the basis of individuals' performance and qualifications. It also encourages companies to comply with the International Labour Organization's standard on non-discrimination (See section 4.5.1 Labour practices).

Affirmative action programmes often raise concerns in this regard, because they are seen as requirements that companies hire or promote a quota of people from certain groups regardless of their qualifications. In fact, affirmative action goals are not incompatible with hiring or promoting based on qualifications if companies actively recruit highly qualified members of under-represented groups.

- [The fund] will vote for proposals asking companies to report on diversity in their workforce, except when those reports already exist and are readily available to shareholders.

- [The fund] will vote for proposals to improve diversity and equity in the workplace, as long as those plans do not set arbitrary or unreasonable goals, or require companies to hire people who are not well-qualified for their positions. It will assess these proposals on an individual basis.

- [The fund] will vote for proposals that prohibit discrimination in employment, including proposals to expand or clarify anti-discrimination policies.

- [The fund] will vote against proposals that would exclude any group of people from policies against employment discrimination.[13]

4.3 Relationships with communities

4.3.1 Political contributions and positions

[The fund] discourages companies from making political contributions of any kind. There are several reasons for this. First, [the fund] believes shareholders' money should not be used to support political parties and causes. Second, this policy prevents the appearance of a *quid pro*

[13] The Canadian Human Rights Act prohibits discrimination on the basis of race, national or ethnic origin, colour, religion, age, sex, sexual orientation, marital status, family status, disability, and conviction for which a pardon has been granted. R.S., 1985, c. H-6, s. 3; 1996, c. 14, s. 2.

quo and resulting negative publicity, should politicians or governments adopt policies favourable to the company. Third, this policy prevents political parties, candidates, or other organizations from exerting pressure on companies to contribute to political campaigns.

[The fund] recognizes that in countries whose safeguards against bribery are inadequate, companies that do not make political contributions may be at a competitive disadvantage. However, making political contributions under these circumstances contributes to corruption and undermines fair competition. Furthermore, being associated with such practices damages a company's reputation, which harms its profitability.

- [The fund] will vote for proposals to ban corporate political contributions.

- [The fund] will vote for proposals requiring companies to disclose the amounts, rationale, and recipients for any contributions they make to political parties, candidates for public office, political action campaigns, and other political contributions, provided this can be done without undue expense.

4.3.2 Fairness in lending, investing, and locating branches or retail outlets

Corporations can foster a strong reputation in the communities in which they operate by making their services equally available to everyone in the community. Residents of low-income neighbourhoods and rural areas often have less access to insurance, credit, bank branches, and retail stores than people in more affluent urban areas. Businesses have sometimes been reluctant to provide services in low-income neighbourhoods and rural areas because they are traditionally considered to be unprofitable. However, an absence or withdrawal of services contributes to the deterioration of these areas. Furthermore, by assuming that doing business in these areas is unprofitable, companies may overlook potential markets or business opportunities.

- [The fund] will vote for proposals that ask companies to report on their efforts to ensure fair access to their products and services within the communities in which they operate.

- [The fund] will assess proposals that ask companies to provide services in under-served areas on a case by case basis.

4.3.3 Predatory lending

Predatory lending is the practice of lending to borrowers who have an inadequate ability to repay the loan. It is often done in association with sales practices that obscure the full cost of borrowing. Such practices expose corporations to uncollectable debt and litigation. Even where they are unregulated, these practices post a significant risk to the reputation of the lender.

- [The fund] will vote for proposals calling for companies to develop, enforce and report to shareholders on the implementation of policies barring predatory lending practices.

4.3.4 Reincorporation in off-shore tax havens

(Also see section 3.4.7 Reincorporation).

So-called “tax havens” are countries with no taxes or nominal taxes, weak requirements for corporate transparency, no effective exchange of taxpayer information with other countries, and no requirement that a company engage in substantial activities in the country in order to incorporate there. Companies can reincorporate in these countries with a minimal investment — sometimes nothing more than renting a mailbox — and shield their finances from tax and regulatory authorities in other countries.

The Organization for Economic Cooperation and Development calls these countries harmful preferential tax regimes, because they distort trade and investment patterns, erode national tax bases, and undermine the fairness of other countries’ tax structures by shifting more of the tax burden onto less-mobile sectors of national economies, such as consumption and labour. By reincorporating in tax havens, companies escape paying taxes in the countries where they earn profits, and where they benefit from the infrastructure and services provided by taxpayers. [The fund] believes this practice gradually undermines the economies of countries without harmful preferential tax regimes.

- [The fund] will vote against proposals to reincorporate in countries that the OECD has identified as having harmful preferential tax regimes. This includes proposals to reincorporate to take advantage of harmful preferential tax regimes that apply only to certain locations or business sectors.[14]

- [The fund] will vote for proposals to prohibit companies from reincorporating in tax havens.

4.4 Dangerous products & product liability

Although no responsible business would intentionally cause public harm, some products prove to be clearly or potentially dangerous, and sometimes the public becomes intolerant of hazards they had previously accepted. In these circumstances, the products in question become a potential liability to their producers, dealers, and shareholders.

[The fund] encourages companies to take a precautionary approach to products that could cause harm by conducting their own studies of the product and following the progress of independent research. Shareholder proposals regarding product liability have asked companies to report on the potential hazards and attendant liabilities associated with their products, or asked companies to cease making the products.

Where companies use processes or substances in their operations that have been shown to be hazardous — for example, the use of mercury in the production of thermometers — the fund encourages them to develop and implement plans to end the use of those processes or substances.

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[14] These countries change from time to time. Current lists can be found in the OECD’s updates on tax havens. On the internet, see *http://www.oecd.org/EN/documents/0,,EN-documents-103-3-no-4-no-103,00.html*.

- [The fund] will vote for proposals that ask companies to report to shareholders on the potential hazards of their products, processes or services and/or on the steps taken to manage risks related to processes and products, as long as competitively sensitive information can be excluded.

- [The fund] will vote for proposals asking companies to disclose any known potential liabilities of their processes or products they make or sell, including 1) the results of any research they have done or commissioned, 2) plans for phasing out dangerous products or changing them to eliminate the risks associated with a product, and 3) where appropriate, their standards for advertising potentially hazardous products responsibly and their compliance with those standards. The proposals should allow competitively sensitive information to be excluded from disclosure.

- [The fund] will assess proposals to end the use of a process or the production or sales of a product on a case-by-case basis. This assessment will include the potential hazards and liabilities associated with the process or product and the costs of eliminating it.

4.4.1 Genetically modified organisms

Proposals concerning genetically modified organisms (GMOs) normally ask the companies to report on their use of GMOs and/or the attendant risks of such use, to label their products that contain GMOs, or to stop producing or using GMOs altogether.

The risks and concerns for shareholders vary greatly because there are so many types of GMOs. Some GMOs present relatively little potential risk to investors, such as the use of transgenic mice in controlled laboratory settings.

However, the risks surrounding the use of other GMOs are proving to be greater than was generally believed a few years ago. Most of the current concern surrounds genetic modification in food crops and animals. For example, the contamination of non-modified food crops by the genetic material of transgenic crops has resulted in lawsuits, regulatory sanctions, and product recalls costing billions of dollars.[15] Even greater concerns arise about the contamination of food by plants that are engineered to produce chemicals for pharmaceutical use. If key genetic material from these plants enter food crops, the risks to human health and the environment could be serious indeed.[16] Transgenic material has been shown to spread over larger distances, and into

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[15] Aventis has lost nearly US$1 billion because genetic material from its StarLink corn, which was not approved for human consumption, has been found in corn intended for human consumption. This has led to the recall of over 300 products to date and lawsuits by farmers and food retailers. Julie Vorman. “StarLink Recall Climbs to 300 Different Items” *Reuters*. 1 November 2002; Stuart Laidlaw. “StarLink Fallout Could Cost Billions” *Toronto Star*. 9 January 2001.

[16] This has already happened in the United States. In 2002, more than 500,000 bushels of soybeans and corn were found to be contaminated by corn that had been genetically modified to produce a pig vaccine. Regulators fined the producer, ProdiGene, US$250,000 and required it to spend US$3 million to destroy the contaminated corn and soybeans. The company also had to post a US$1 million bond in anticipation of future problems. T. Hesman. “Crop Experiments Get More Watchful Look: USDA Ordered Destruction of Soybeans After Contamination” *St. Louis*

a wider variety of other organisms than was originally anticipated. This greatly increases the risk of contamination, with its attendant liabilities. Such risks have led insurers in Europe and Australia to refuse to insure transgenic crops or companies that produce them.

In addition, food products containing GMOs are subject to market rejection due to consumer concerns about their safety. Consumer concerns have led to restrictions on GMO-containing products in some countries and rejection by individual food manufacturers and retailers.

Consumers have also demanded that products containing GMOs be labelled. Overseas markets, including the European Union, Japan, and Australia, require foods containing GMOs to be labelled as such. Surveys done in the United States consistently show that roughly 70% to 90% of consumers there want products containing GMOs to be labelled.

[The fund] believes that shareholders must be aware of the risks presented by a company's use of GMOs. This information should be provided to shareholders regularly. [The fund] also believes that companies should label or otherwise identify their products that contain GMOs. The high consumer demand for labelling and the labelling requirements in other countries make it likely that companies will enjoy greater access to markets, a better reputation, and greater consumer satisfaction if they label their GMO products.

- [The fund] will vote for proposals that ask companies to report on their use of GMOs and the attendant risks, provided these reports are produced at a reasonable cost and that proprietary information is safeguarded.

- [The fund] will vote for proposals that ask companies to label their products that contain GMOs.

- [The fund] will assess proposals to stop producing or using GMOs on a case-by-case basis. This assessment should include careful consideration of the potential liabilities from the GMOs at issue, the anticipated market for products containing GMOs, the costs of market failure, the findings and status of current independent research on the safety of the GMOs, and any issues related to insurance that may arise.

4.5 Environmental issues

Companies should protect the environment and public health and safety in their operations and products. Failure to do so risks not only injury to public health or environmental harm, but also legal liability, remediation costs, the costs of unplanned and possibly significant changes in operations, and a damaged reputation. All of these diminish shareholder value. The best way to minimize these risks is through the use of the precautionary approach, that is, by investigating and testing operations and products for their effects on the environment before they are put into

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Post-Dispatch. 22 November 2002; US Dept. of Agriculture, "USDA Announces Actions Regarding Plant Protection Act Violations Involving ProdiGene Inc." Press Release. 6 December 2002.

use. The precautionary approach is described in greater detail in the United Nations Global Compact.

The Coalition for Environmentally Responsible Economies, or CERES, has established a set of broad environmental principles for corporations.

- [The fund] will vote for proposals asking companies to adopt the CERES principles.

In addition, [the fund] recommends that companies adopt the UN Global Compact's three principles concerning the environment, including their supply chains. (See section 4.1.1 International standards and norms). These principles include:

  - adopting a precautionary approach to environmental protection, as long as this does not violate the laws and regulations of the host country;
  - taking initiatives to promote greater environmental responsibility in a way that is appropriate for the size and nature of the business; and
  - encouraging the development, improvement, and spread of environmentally friendly technologies.

- [The fund] will vote for proposals calling for companies to adopt and comply with the Global Compact guidelines and to report to shareholders on their progress in implementing them.

- [The fund] will vote for proposals that ask companies to adopt environmental standards specific to their industry or sector as long as these standards are at least as stringent as the CERES principles.

4.5.1 Environmental reporting

[The fund] encourages companies to report on their environmental performance. At a minimum, companies should report on their potential environmental liabilities, their performance against relevant performance criteria, their plans for improving their environmental performance, and their progress in making those improvements.

The Global Reporting Initiative and CERES have coordinated their standards for reports on environmental performance. [The fund] encourages companies to follow either set of standards for their environmental reports.[17]

- [The fund] will vote for proposals that ask companies to provide reports on their environmental performance, including reports on environmental effects of specific aspects of their operations or specific products.

- [The fund] will vote for proposals asking companies to using either the GRI or CERES standards for their environmental reports.

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[17] The CERES reporting standards are available on their internet site, *http://www.ceres.org/our_work/ environmental_reporting.htm*.

4.5.2 Managing environmental risks

Where companies' operations or products run a high risk of environmental damage, [the fund] encourages companies to develop and maintain contingency plans for preventing, mitigating, and controlling damage to the environment and risks to human health. This would include plans for accidents or emergencies. These plans should be approved by relevant governmental authorities, such as disaster management, environmental safety, and public health agencies.

- [The fund] will vote for proposals calling for companies to report to shareholders on the steps taken to manage risks related to potentially hazardous processes and products, including independent verification of audits and environmental impact statements.

4.5.3 Climate change

Climate change is emerging as a major risk for businesses. It has investment implications for shareholders and especially for institutional investors whose diverse portfolios expose them to risks across a wide range of economic sectors. The Investor Network on Climate Risk publishes a guide to evaluating the potential risks for investors.[18]

According to the United Nations' Intergovernmental Panel on Climate Change, the likely consequences of global climate change include rising sea levels, an increase in violent storms, floods and droughts, changes in ocean and atmospheric patterns, the spread of tropical diseases to temperate regions, and a significant reduction of land suitable for agriculture. The consequences of such changes could profoundly affect businesses of all kinds. A survey of FT500 companies conducted in 2002 found that 80% of the respondents recognize the risks involved in climate change, and are prepared to capitalize on trends in clean technologies.[19]

Shareholder proposals on climate change have asked companies to report on their greenhouse gas emissions and their financial exposure for damages associated with climate change. Proposals have also asked companies to report on research and actions to reduce their greenhouse emissions, to promote renewable energy, and to reduce their use of fossil fuels.

- [The fund] will vote for proposals asking companies to report on their greenhouse gas emissions, their financial exposure for damages associated with climate change, and the evaluation of various options to reduce their liabilities related to greenhouse gas emissions and/or climate change.

- Proposals calling for companies to implement measures to reduce their greenhouse gas emissions will be evaluated on a case-by-case basis, taking into account companies' current levels of emissions and the effectiveness of any programmes they have to reduce those emissions.

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[18] *See*, "Investor Guide to Climate Risk: Action Plan and Resource for Plan Sponsors, Fund Managers and Corporations", Investor Network on Climate Risk. July 2004. http://www.incr.com.
[19] Carbon Disclosure Project and Innovest Strategic Value Advisors, "Carbon Finance and the Global Equity Markets" February, 2003. http://www.cdproject.net.

4.6 International operations

International operations are a highly complex area of business operations, and of corporate social responsibility. They demand that corporations reconcile differences in legal regimes, cultural values and practices, and consumers' and workers' interests. The Organization for Economic Cooperation and Development (OECD), of which Canada is a member, has established Guidelines for Multinational Enterprise that set standards for international operations in labour, the environment, consumer protection, fair competition, science and technology, and taxation. These guidelines were developed in cooperation with representatives from business, labour and the governments of OECD member countries. [The fund] recommends that companies adhere to the OECD Guidelines for Multinational Enterprise.

4.6.1 Labour practices

One of the appeals of moving production overseas is that doing so allows corporations to take advantage of lower prevailing wages in some countries. Unfortunately, some corporations have sought an unfair competitive advantage by lowering their labour standards. As a result, multinationals and their host countries are widely perceived as being in a labour-standards race to the bottom, promoting child and forced labour, long hours at less than subsistence wages, and dangerous working conditions.

Consumers strongly support responsible labour practices in companies' overseas operations. For example, an Ipsos-Reid survey in 2000 found that 44% of Canadians had boycotted a corporation's products or services in the previous year because of concerns about its ethics. An Environics International study of over 20,000 citizens in 20 countries found that consumers in wealthy countries based their impression of a company more on its social performance, including labour practices, than on brand image.[20] Furthermore, when a company becomes associated with abusive working conditions the result is often consumer boycotts, worker lawsuits, and divestiture or avoidance by institutional investors.

To ensure that consistently high standards are used in global employment practices, [the fund] encourages companies to adopt the International Labour Organization's Fundamental Principles and Rights at Work. These standards are also included in the United Nations' Global Compact as its four principles on labour, and they have been incorporated into the OECD's Guidelines for Multinational Enterprise. The core labour standards include:

- Freedom of association, including the right to organize, hold meetings, and bargain collectively without coercion or interference;
- Abolition of forced labour, such as indentures or labour as punishment for the expression of political views;
- Ending discrimination in employment based on race, creed, colour, political opinion, social origin, or sex. This includes equal access to employment and training, and an end

[20] "Executive Brief", *Corporate Social Responsibility Monitor.* Environics International. *http://www.environicsinternational.com*. 2001.

to discrimination in working conditions. It also includes equal pay for men and women for work of equal value; and

= Abolition of child labour. As the UN Global Compact points out, there are situations in which children must work in order to survive. But they must not be exploited or placed in dangerous environments, their educational needs must be catered to, and employers should replace child labour in a way that adds to the human capital development of society and preserves children's lives.

- [The fund] will vote for proposals that ask companies to adopt and comply with the ILO standards.

- [The fund] will vote for proposals that ask companies to provide shareholders with independently verified reports on their progress in implementing the ILO standards.

4.6.2 Environmental practices in international operations

[The fund] believes that companies should adhere to the same high standards for environmental performance in all of their operations, even if local standards are lower. The CERES principles and the United Nations Global Compact, referred to in Section 4.5.1, are applicable to international as well as domestic operations.

- [The fund] will vote for proposals calling for companies to adopt and comply with the CERES principles and with the Global Compact in their international operations.

- [The fund] will vote for proposals that ask companies to report to shareholders on the environmental aspects of their international operations using the GRI format.

4.6.3 Human rights

Conducting business in a country that has been accused of persistent gross and systemic violations of human rights can jeopardize a company's reputation, even if the company tries to distance itself from the human rights abuses. If the company also has a significant presence in the United States or Great Britain, it may be vulnerable to tort lawsuits under the laws of those countries. Companies that do business in countries with a record of systemic human rights violations may also be subject to consumer boycotts or campaigns, which can damage corporate reputations and hurt profits. In assessing the effects of their operations on human rights in these circumstances, companies should consult with reputable civil society organizations and human rights experts. Adhering to the ILO Fundamental Principles and Rights at Work (see section 4.5.1) may help companies to avoid being associated with human rights abuses.

- [The fund] will vote for proposals that ask companies to adopt, comply with, and report on their compliance with international human rights standards, including the Universal Declaration of Human Rights.

- [The fund] will vote for proposals that ask companies to consult with stakeholders on the effects of their operations on human rights, including organizations with expertise in human rights.

4.6.3.1 Operations in zones of conflict

Companies that operate in zones of conflict risk harm to their employees and physical assets, damage to their reputations, and exposure to possible litigation or public divestment campaigns. Corporations should pay special attention to the effects of security arrangements on local communities. Corporations should also pay attention to the effect their operations have on the conflict itself, e.g. where tax or royalty payments to one party cause the conflict to escalate, or where rights to resources being developed are themselves a major cause of the dispute.

[The fund] encourages companies to ensure that security arrangements do not violate the rights of local communities and that their operations do not exacerbate violent conflicts.

- [The fund] will vote for proposals that ask companies operating in conflict zones to establish policies to protect the rights of local communities and to avoid exacerbating conflicts.

- [The fund] will vote for proposals that ask companies to monitor compliance with those policies, and to provide shareholders with independently verified reports on their adherence to those policies.

4.6.3.2 International sanctions and proposals to cease operations

On rare occasions economic sanctions imposed by individual states or by multi-lateral governmental organizations, such as the United Nations, bar companies from operating in certain countries or doing business with certain non-governmental entities, such as paramilitary groups, rebel armies, or drug cartels. International economic sanctions are imposed when a government or other entity has committed egregious, long-standing violations of international law. In situations where legally binding sanctions are not imposed by governments, shareholder proposals may ask a corporation to cease operations or divest itself of holdings in a particular country.

- If legally binding sanctions have not been imposed on a country, [the fund] will assess proposals to cease operations in that country on a case-by-case basis. Factors that may be applied in making this assessment include Canadian government policy, the position of international organizations, the nature of the corporation’s business, its relationship with the government or entity in question, and reports by independent observers.

4.6.4 Monitoring foreign contractors

A large portion of overseas manufacturing for North American companies is done through contracting and subcontracting, rather than through facilities owned directly by the companies. This makes it possible for a company's products to be produced in conditions that violate international labour and environmental standards, with all of the attendant liabilities, without the company's knowledge — unless that company makes an effort to learn about their contractors' operations, and insists on operating practices that conform to international standards as a condition for awarding the contract. However, the number and diversity of contractors involved makes insisting on international standards and enforcing them a complex matter.

For this reason, [the fund] encourages companies to establish a monitoring process that includes independent verification of contractors' compliance with labour and environmental standards. [The fund] recommends involving local religious, human rights and workers' organizations that are independent and well-respected in the monitoring process, and using incentives, rather than premature termination of contracts, to encourage suppliers to raise their labour and environmental standards.

- [The fund] will vote for proposals that ask companies to use qualified, independent monitors to assess their contractors' adherence to labour and environmental standards.

- [The fund] will vote for proposals that ask companies to provide shareholders with independently verified reports on their adherence to labour and environmental standards and their plans for improving their performance.

4.6.5 Drug pricing policies for developing countries

Recently, pharmaceutical companies have been criticized for pricing drugs for HIV-AIDS and other diseases beyond the means of people in developing countries, where treatments for these diseases are needed most. Critics accuse pharmaceutical companies of contributing to the devastating effects of diseases in poorer countries by making the drugs too expensive for individuals or their governments. Some developing countries have begun manufacturing cheaper, generic versions of these drugs, in violation of international patent laws, in order to make the drugs available to their citizens.

Shareholder proposals have asked pharmaceutical companies to make drugs available in developing countries at a reduced price or at no charge. This creates a dilemma for management, and for institutional fund managers. Companies do not want to create an incentive for those who would violate their patents. But pharmaceutical companies incur large costs developing their products, costs they usually recover by selling the drugs at a profit. In order to make the drugs affordable for the world's poorest people, they must sell the drugs at a less profitable price, sometimes below the cost of production.

Some pharmaceutical companies, such as Merck and Abbott Laboratories, have responded to this dilemma by making drugs available at no cost or at prices that return no profit, and treating the expenses involved as charitable contributions. [The fund] encourages pharmaceutical companies

to follow their example. Doing so will enhance the company's reputation, help them to protect their patents, and thus improve their profitability in the long term.

- [The fund] will vote for proposals to make pharmaceuticals available to developing countries at affordable prices, unless management can show that the costs of doing so would cause the company serious harm.

REFERENCES

The following documents were used as references in developing these guidelines but were not cited in the text.

The proxy voting guidelines of:

The America Federation of Labor-Congress of Industrial Organizations (AFL-CIO)
Alberta Revenue Investment Management Division
British Columbia Investment Management Corporation
California Public Employees' Retirement System
Calvert Group, Inc., Social Investment Funds
The State of Connecticut, Office of the Treasurer
Christian Brothers Investment Services
Domini Social Investment Fund
The Episcopal Church
Ethical Funds, Inc.
The Florida State Board of Administration
The General Board of Pension and Health Benefits of the United Methodist Church
Hermes Investment Management Ltd.
Hospitals of Ontario Pension Plan
The New York City Board of Education Retirement System, City Employees' Retirement System, Fire Department Pension Fund, and Police Department Pension Fund
Ontario Teachers' Pension Plan
Ontario Municipal Employees' Retirement System
Ontario Service Public Employees' Union Pension Trust
Teachers' Insurance and Annuity Association - College Retirement Equities Fund
The United Brotherhood of Carpenters and Joiners
The State of Wisconsin Investment Board
Working Enterprises

Organization for Economic Cooperation and Development, *OECD Principles of Corporate Governance*. http://www.oecd.org/document/49/0,2340,en_2649_201185_31530865_1_1_1_1,00.html. April, 2004.

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Pension Investment Association of Canada, *PIAC Corporate Governance Standards*. June 1988; *PIAC Corporate Governance Standards 2001 Update*, January 2002. Both publications are available at http://www.piacweb.org/publications_governance.cfm.

Tripartite Declaration of Principles Concerning Multinational Enterprise and Social Policy. OB Vol LXXXIII, Series A, No. 3. http://www.ilo.org/ilolex/english/iloquerymtn1.htm. 2000.

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Canadian Democracy and Corporate Accountability Commission, *The New Balance Sheet: Corporate Profits and Responsibility in the 21st Century* January 2002.

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The American Federation of Labor and Congress of Industrial Organizations, Petition to the US Securities and Exchange Commission. December 2001.

Investor Network on Climate Risk. *Investor Guide to Climate Risk: Action Plan and Resource for Plan Sponsors, Fund Managers and Corporations.* http://www.incr.com. July 2004.

Internet Resources

The following web sites are good sources of information on proxy-voting, corporate governance, and corporate social responsibility.

The Pension Investment Association of Canada (PIAC) -http://www.piacweb.org/home.cfm

The Corporate Library - http://www.thecorporatelibrary.com/

The World Bank, Corporate Governance Best Practices page - This is a list of links to international corporate governance sites, including the OECD's corporate governance web site. http://www.worldbank.org/html/fpd/privatesector/cg/codes.htm

The Council of Institutional Investors - http://www.cii.org/

"Conversations with Disbelievers" - is a project of the Center for Corporate Citizenship at Boston College. http://www.conversations-with-disbelievers.net/

The Social Investment Forum, Shareholder Action Network - http://www.shareholderaction.org/proxy.cfm

The Investor Responsibility Research Center - http://www.irrc.org/

Ethical Funds Inc. - http://www.ethicalfunds.com/do_the_right_thing/sri/shareholder_action/proxy_voting.asp

Several institutional investors are very active in proxy voting and have posted their guidelines on the internet:

The California Public Employees' Retirement System, or CALPERS, shareowners' forum http://www.calpers-governance.org/

The Ontario Municipal Employees' Retirement System (OMERS) - http://www.omers.com/investments/proxyvoting_guidelines/contents.htm

The British Columbia Investment Management Corporation - http://www.bcimc.gov.bc.ca/publications/

The Ontario Teachers' Pension Plan (OTPP) - The OTPP has made a major commitment to proxy voting. In addition to its guidelines, its web site shows how it voted its proxies in past proxy seasons, and how it plans to vote on upcoming issues. http://www.otpp.com/web/website.nsf/web/CGIntroduction