SHARE | Shareholder Association for Research and Education

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Dear Mr. Ziegler:

Re: Proposals for Amendments to the Pension Benefits Act of Manitoba

Thank you for the opportunity to provide comment on the Manitoba Pension Commission's *Proposals for Amendments to the Pension Benefits Act of Manitoba.* We only recently became aware of the review initiative and appreciate that we have missed the formal deadline for submissions, but understand that the Pension Commission will be meeting on 25 February 2003 and have been informed through Ray Erb at the Manitoba Government and General Employees Union that our submission will be considered at that time.

The Shareholder Association for Research and Education (SHARE) is a national, not-for-profit organization established in September 2000 to support responsible investment practices by pension trustees. For us, responsible investment practices include promoting financially sound investment practices by pension funds that protect the long-term best interests of pension plan members, beneficiaries, and society, and empowering trustees through on-going education to fulfill their fiduciary duties competently and effectively.

As the Pension Commission's consultation document rightly points out, there have been significant changes in the legislative landscape and provincial demographics since the Act was last reviewed in 1983. What the consultation paper does not capture is the equally significant changes with respect to the investment side of pension plans. The past several decades have seen enormous growth in the total assets held by trusteed pension plans in Canada to more than $580 billion. Trusteed pension plans now represent the second largest pool of investment capital in Canada. As such, the power and profile of pension investment has grown and plan members are increasingly interested in how their plan assets are being invested. How pension assets are invested has implications for plan members retirement security as well as their general well-being by virtue of the impact that pension investments have on the Canadian economy, society and the environment.

Second, most jurisdictions have moved from a list of permissible investments to a "prudent person" standard of care. Consequently, more discretion is now left to pension trustees and their investment managers in making investment decisions.

We are pleased to see that these changing investment realities are acknowledged by some of the Pension Commission's recommendations. We take this opportunity to expand on these recommendations in a number of key areas related to pension investment and plan governance – expansion of provision of information and inspection, pension committees and administrators – as well as introducing recommendations around clarification of the prudent person standard of care with respect to pension investments.

Expansion of Provision of Information and Inspection

We strongly support the Pension Commission's assertion that fuller disclosure and access to information will add transparency to the administration and funding of pension plans. As we have witnessed in the context of corporate governance over the past several years, transparency and disclosure are requisite parts of good governance.

The Pension Commission's proposal to provide individuals on written request with a list of the investments held in the name of the plan and the most recent audited financial statement of the plan are both welcome additions to current disclosure practices. In addition, we recommend the following further disclosures as part of a disclosure regime that recognizes the increased awareness and understanding of pension plans by plan members.

i. Disclosure of Social and Environmental Investment Criteria

The primary objective of pension policy is to protect the retirement security interests of plan members. There is mounting evidence that demonstrates a positive correlation between non-financial dimensions of corporate performance and share value (see Appendix A), and that successfully fulfilling the mandate to protect retirement security requires embracing principles that foster a sustainable economy and society. Pension plan members want to ensure that their plan's investments are achieving these mutually supportive objectives. According to a December 2001 Vector Research survey, a majority of Canadians, as pension plan members and beneficiaries, support pension plan's disclosing socially responsible criteria used for selecting investments. The survey found 51% of all Canadians want their pension plans to invest in companies with a good record of social responsibility, even if it were to result in slightly diminished returns. A disclosure requirement would ensure that these aspects of investment practice are considered by pension plans in setting investment policy.

Other countries have already acknowledged this in reforms to their pension regimes. The British government amended its pension regulation in 2000 to require pension plans to disclose in the annual report to plan members:

> (a) The extent (if at all) to which labour rights, social, environmental and ethical considerations are taken into account in the selection, retention and realisation of investments; and
>
> (b) Their policy (if any) in relation to the exercise of the rights (including voting rights) attaching to investments.

These amendments have since been adopted in Germany, France, Belgium, Sweden and Australia. Reports from European sources indicate that similar provisions are being considered by Austria, Spain, Denmark, Switzerland, and Italy.

Following the introduction of the UK pension regulations, a study released in October 2000 by the UK Social Investment Forum revealed that fifty-nine percent of UK pension funds were incorporating SRI principles into their investment process, either via the fund manager, or through engagement, or both. Thirty-nine percent of funds mentioned corporate engagement in their investment policy document.

In its recently released final report titled *The New Balance Sheet,* the Commission on Canadian Democracy and Corporate Accountability acknowledged the British reforms and recommended that "…pension funds should be obliged to indicate in their statements of investment policies and procedures whether or not they take into account considerations contained in the [corporate social responsibility] CSR Guidelines [as articulated in the report] in making investment decisions."

We believe that requiring disclosure of the criteria applied in selecting investments is not only an essential part of good plan governance, but will encourage investment in sustainable vehicles that represent prudent, long-term options. By requiring disclosure of such information, the government is not mandating such investments, but simply encouraging greater transparency and awareness by plan trustees and members in this area.

Accordingly, SHARE recommends that the Manitoba *Pension Benefits Act* be amended to require pension plans to disclose in their annual benefits statement to plan members the extent (if at all) to which social (labour standards and human rights) and environmental considerations are taken into account in the selection, retention and realisation of investments.

ii. Proxy Voting Guidelines and Proxy Voting Records

According to the Office of the Superintendent of Financial Institutions, the body responsible for regulating federally-registered pension plans, proxies attached to shares of companies in a pension plan's portfolio are considered valuable plan assets. OSFI's *Guideline for the Development of Investment Policies and Procedures for Federally Regulated Pension Plans* (April 2000 and available at www.osfi-bsif.gc.ca/eng/pensions/guidelines/ pdf/penivst.pdf.) affirm that proxies are valuable plan assets, must be delegated or retained, and voted in the best interests of plan members:

> "Plan administrators should not ignore the value of voting rights acquired through plan investments. Shareholder votes are often most valuable when used in alliance with others. Failure to describe in the investment policy how these rights will be used leaves plan administrators open to charges of either negligence or arbitrary action, possibly in violation of the standard of care requirement. Investment policies should describe and require the use of voting rights, whether directly or through proxy.

> If the power to vote proxies is delegated to investment managers, proxies should be bound by rules established in the investment policy. The administrator should receive a report showing how proxies were voted, and affirming compliance with the administrator's proxy voting policy." (OSFI, 2000, endnote 4, Appendix I, section I.6.6)

This guidance suggests that the voting of proxies has value to a pension plan and is possibly part of the fiduciary responsibilities of pension trustees. Furthermore, pension legislation today requires that pension plans have a Statement of Investment Policy and Procedures (SIPP). The SIPP is required to indicate whether voting rights attached to shares owned by the plan are delegated or retained. Accordingly, there is an implied obligation on the part of the plan to vote its proxies.

Given the importance attached to proxy votes, we submit that Manitoba's pension regime echo the OSFI guidance and allow for plan members to obtain information on how proxies are being voted.

The corporate debacles in the United States have raised awareness of the role that shareholders have in ensuring proper corporate governance and the financial consequences of failing to hold companies accountable. The US Securities Exchange Commission has acknowledged the importance of shareholder democracy in new rules that require all investment managers to disclose their proxy voting guidelines and proxy voting records. Similarly, the Canadian Securities Administrators recently proposed National Instrument 81-106 that will require all investment funds summarize in the Management Discussion of Fund Performance (MDFP) how they voted on matters, other than routine business, with respect to issuers of portfolio assets held by the fund.

While these developments are directed at the retail market, they also have implications for the pension sector. By virtue of NI81-106, plan members of defined contribution plans that include mutual funds as part of plate of investment options will receive information on how managers are voting proxies. In contrast, plan members in defined benefit plans will not. This inequality in access to information can be remedied by making similar information available through pension disclosure requirements.

This pension reform has been adopted by Britain, Germany, France, Belgium, Sweden and Australia as part of the regulatory amendments identified above. In Canada, many pension plans have begun to voluntarily disclose their proxy voting guidelines and records, including the Ontario Teachers' Pension Plan and Ontario Municipal Employees' Retirement System.

Accordingly, SHARE recommends that the Manitoba *Pension Benefits Act* require pension plans to disclose in their annual benefits statement to plan members their policy (if any) in relation to the exercise of the rights (including voting rights) attaching to investments, and notify plan members that they may review the plan's proxy voting guidelines and voting records upon request.

The disclosure requirements proposed above are fully consistent with the objectives of pension regulation and the Manitoba government, namely protecting the interests of plan members,

instilling investor confidence, minimizing regulatory burden and fostering sustainable development. The proposed amendments support full and open accounting of how pension plans exercise their fiduciary duties in investing plan assets thereby fostering greater confidence amongst plan members and their beneficiaries. Rather than mandating performance requirements, the proposed reforms take a facilitative approach. Additional administrative burden is minimized. Information to be disclosed is to be included in the annual statement already provided to plan members pursuant to statutory requirement. Pension funds should already have statements in their investment policies to the extent that they consider non-financial investment criteria, as well as internal proxy voting guidelines or those of their investment managers as part of prudent plan governance and require no additional effort on the part of plan administrators, trustees or professional consultants. And finally, to the extent that these new reporting requirements stimulate trustees to examine new investment opportunities, the proposed amendments will support the long-term creation of new and innovative industries that promote sustainable development.

These options will harmonize provincial pension disclosure policy with that in other OECD countries. Its focus on disclosure seeks to balance the needs of the public and plan beneficiaries for more information with the resource limitations of pension plans. The proposal does not mandate that pension plans incorporate specific investment practices, but rather uses disclosure as a means of encouraging greater transparency and accountability amongst pension plans and investment managers. As stated, over the long-term, benefits are also anticipated through increased investment in responsible and sustainable industries.
Finally, it is important that plan members are aware of the various information that they are entitled to obtain from the plan administrator. Disclosure is important, but of little value if plan members are not aware that they are entitled to obtain the information. **Accordingly, SHARE recommends that the plan's annual benefit statement to plan members be required to list the types of information that plan members may request.**

iii. Pension Committees

SHARE generally supports the position put forward by the Manitoba Federation of Labour in their submission to the Pension Committee that plan members should have a prominent role in the oversight of their pension plan and hold a majority of positions on a pension committee.

Over the past several years, we have witnessed a number of plans across the country move towards a joint trusteeship arrangement with favourable results. The involvement of plan members in plan governance is part of a regime that ensures that the best interests of plan members are reflected in the plan's policies and practices.

Accordingly, SHARE endorses the view that the pension committee should be the administrator of the pension plan with a majority of seats held by individuals either appointed by elected worker representatives or elected directly by the plan members. Positions should be retained for non-active members and beneficiaries on the committee and these individuals should also be either appointed by elected worker representatives or elected directly by the plan members.

iv. Administrators

SHARE supports the Pension Committee's proposal to recognize that that the pension plan administrator is the party generally responsible for administering the plan and the pension fund in accordance with the Act, regulations and the terms of the pension plan.

v. Prudent Person Standard of Care

In addition to the issues identified by the Pension Commission in its consultation document, SHARE would like to address the pension trustee standard of care under Manitoba's Pension Benefit Act.

Section 28.1(2) of the *Pension Benefits Act* requires that "the administrator of a pension plan shall exercise the care, diligence and skill in the administration of the plan and in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person." We submit that the pension investment practices by provincial pension plans would benefit from clarification that the standard of care does not prohibit consideration of non-financial criteria by pension trustees in relation to plan investments, such as corporate governance, social and environmental criteria, provided such considerations are made in the context of a prudent investment strategy.

In 1993, the Manitoba government on the recommendation of the Manitoba Law Reform Commission (Manitoba Law Reform Commission, *Ethical Investments by Trustees* (Winnipeg: Manitoba Law Reform Commission, January 1993) at 38) took an unprecedented step in amending the *Trustee Act* to include a unique additional provision that explicitly permits trustees to consider non-financial criteria in developing investment policies:

> 79.1 Subject to any express provision in the instrument creating the trust, a trustee who uses a non-financial criterion to formulate an investment policy or to make an investment decision does not thereby commit a breach of trust if, in relation to the investment policy or investment decision, the trustee exercises the judgment and care that a person of prudence, discretion and intelligence would exercise in administering the property of others.

The Manitoba Law Reform Commission reconsidered section 79.1 in 1999 and decided to retain it.

SHARE believes that similar clarification in the context of the standard of care for pension trustees is merited. Currently, pension trustees have shown great reluctance to consider non-financial investment criteria for fear of being found in breach of their fiduciary duties. This interpretation of trustee fiduciary responsibilities in the context of pension investment is based on a selective reading of existing jurisprudence that is not consistent with recent empirical evidence, conflicting jurisprudence, and regulatory advances such as the new disclosure requirements in Britain and other OECD countries (For a full discussion of this issue see Gil Yaron, "The Responsible Pension Trustee" (June 2001) 20(4) *Estates, Trusts & Pensions Journal* 305 available at <www.share.ca>.) Furthermore, we have presented evidence supporting the position that consideration of corporate governance, and social and environmental corporate practices can have a positive material impact on investment returns (see Appendix A).

In the absence of any foreseeable judicial statements from Canadian courts clarifying the scope of fiduciary duties in this context, SHARE recommends that **the Manitoba *Pension Benefits Act* be amended to include a provision similar to section 79.1 in the Manitoba *Trustee Act* clarifying that trustees may take non-financial criteria into consideration when making investment decisions provided trustees exercise the requisite degree of care and prudence as they would in other cases when administering the property of others.**

We commend the Manitoba Pension Commission on the many proposals that seek to encourage active trusteeship, healthy plan governance and plan member awareness as a foundation for sustainable investment practices. SHARE is committed to supporting responsible investment practices by pension plans and trusts that Pension Commission will view the proposals outlined above as consistent with these objectives. Should you have any questions about the contents of this submission or require further clarification or information, please contact me directly at the address provided below.

Yours truly,

Gil Yaron, B.A.&Sc., LL.B., LL.M.
Director of Law & Policy

APPENDIX A

Social and environmental information has traditionally been viewed as "external" to a firm's operations and difficult to quantify. However, significant research over the past decade has demonstrated both the financial risk for firms that do not follow prudent social and environmental practices, including implementation of policies and monitoring. Conversely, financial opportunities that enhance share value are missed such as energy and waste reduction, and enhanced goodwill and consumer loyalty.

The following is a summary of a majority of the studies conducted over the past 25 years considering the relationship between social and environmental practices of corporations and share value. The data does not review studies linking corporate governance practices and market value.

(a) General studies

A 1999 review of 52 studies looking at the relationship between CSEP and CFP found that 33 studies suggest a positive relationship, 14 found no effect or were inconclusive, and only five found a negative CSEP/CFP relationship.[1] Similarly, the US Environmental Protection Agency's review of twenty-five major studies examining the correlation between environmental and financial performance concluded:

> "A significant body of academic research relates measures of corporate environmental performance to measures of financial performance. The most striking aspect of this research is that most of it shows a moderate positive relationship between the two kinds of performance – regardless of the variables used to represent each kind of performance, the technique used to analyze the relationship, or the date of the study."[2]

Other discrete studies carried out since then have found similar positive correlations. In one case, a sampling of 243 American firms determined unanticipated earnings advantages for those companies with superior environmental policies.[3] Two others found correlations between cleaner industries and higher market valuations.[4]

Assessing the role of global environmental standards, a study of 89 US-based companies from the S&P 500 involved in manufacturing or extractive industries found that those that employed

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[1] Ronald M. Roman, Sefa Hayibor, and Bradley R. Agle, "The Relationship Between Social and Financial Performance: Repainting the Portrait" (March 1999) 38(1) *Business & Society* 109-125 at 121.

[2] Office of Cooperative Environmental Management, U.S. Environmental Protection Agency, *Green Dividends? The Relationship Between Firms' Environmental Performance and Financial Performance* (May 2000) at 8.

[3] Michael V. Russo & Paul A. Fouts, "A RESOURCE-BASED PERSPECTIVE ON CORPORATE ENVIRONMENTAL PERFORMANCE AND PROFITABILITY" (1997) 40(3) *Academy of Management Journal*, 534-559.

[4] Stuart Hart and Gautam Ahuja, "Does It Pay to Be Green? An Empirical Examination of the Relationship between Emission Reduction and Firm Performance" (1996) *Business Strategy and the Environment*; Andrew King and Michael Lenox, "Does It *Really* Pay to Be Green? An Empirical study of Firm Environmental and Financial Performance" (2000) *Journal of Industrial Ecology*. The latter study analyzed facility date from Dun and Bradstreet, corporate data from Standard & Poor's Compustat database and EPA Toxic Release Inventory Data a for 606 U.S. manufacturing firms between 1987 and 1996. As with other studies, only a correlation was established, not causation. The study could not link the findings to innovation of firms, whether more profitable firms allocated more resources to pollution control technologies, or other firm-specific attributes or strategies.

strict American global environmental standards abroad achieved higher market valuations -- approximately $10.4 billion higher than those using less stringent standards.[5]

(b) Event Studies

An event study focuses on a particular type of event - e.g. product recalls, illegal acts – and try to determine whether the stock market responds to the news of the event.[6]

A meta-study of 27 event studies conducted between 1981 and 1994 found that "substantial losses accrue to the shareholders of irresponsible and unlawful firms."[7] The event studies reviewed considered violations of antitrust laws, mandated recalls of substandard or dangerous products, criminal misconduct, pollution of the natural environment, and violations of regulatory agency standards. Results demonstrated that the negative effect on shareholder wealth by firms engaging in socially irresponsible and illicit behaviour was so substantial that "the distribution of abnormal returns…shifted nearly a full standard deviation to the left (i.e. negatively) from [the] expected standard normal distribution."[8]

Another review of 22 environmental crises (e.g. oil, chemical, or gas spills) at 16 firms between 1989 and 1990, and 110 positive environmental events (e.g. recognition of superior environmental performance by environmental advocacy organizations and government bodies) at 82 firms between 1985 and 1991, resulted on average in a respective loss of $0.70 share and gain of $0.37 per share.[9]

A study of Union Carbide's common stock price following the Bhopal incident where approximately 4,000 people died and 200,000 evidenced a drop in market value of approximately US$1 billion, or 28% within five trading days following the leak, and a sustained drop in stock price over one month following the tragedy. Another 47 chemical firms experienced a vicarious loss in share value for at least ten days.[10]

An historical review of share value for Curragh Inc. following the explosion at Westray Mine that killed 23 miners is entirely consistent with these findings. Curragh Inc. was a publicly traded corporation on the Toronto, Montreal and New York Stock exchanges. On the next business day following the disaster, the Company's share price dropped by almost one-third, one of the largest drops in the Company's history. It recovered slightly in subsequent months only to plummet in the following year prior to it being delisted in 1994. At no time did company

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[5] Glen Dowell, Stuart Hart, and Bernard Yeung, "Do Corporate Global Environmental Standards Create or Destroy Market Value" (2000) 46 *Management Science* 1059-1074. The study noted the public policy implication of these findings that "developing countries using lax environmental regulations to attract foreign direct investment may attract poorer quality, less competitive firms."

[6] Jeff Frooman, "Socially Irresponsible and Illegal Behaviour and Shareholder Wealth" (1997) 36(3) *Business & Society* 221-249 at 224.

[7] Frooman, *supra* note X at 225.

[8] Frooman, *supra* note X at 221.

[9] Robert Klassen and Curtis McLaughlin, "The Impact of Environmental Management on Firm Performance" (1996) 24(8) *Management Science* 1199-1213.

[10] W.G. Blacconiere and D.M. Patten, "Environmental Disclosures, Regulatory Costs, and Changes in Firm Value" (?) 18 *Journal of Accounting and Economics.*

executive disclose information about the dangerous conditions in the mine to workers or investors despite having full knowledge.[11]

(c) Sector-specific Studies

A recent American investigation of the banking sector found "a strong indication that the link between corporate social and financial performance is positive."[12] The study determined that banks that had outstanding compliance with assessment factors under the *Community Reinvestment Act of 1977* (*CRA*) had a significantly higher mean return on assets and lower loan losses than those with only satisfactory compliance. The *CRA* requires regulatory authorities to assess banks based on twelve assessment factors similar to those that Canadian banks must report on in their Public Accountability Statements.[13] High CRA-rated banks were 78% more profitable than low CRA-rated banks and experienced approximately one-half of the loan losses.

(d) Firm-specific studies

A report from the World Resources Institute surveying 13 American pulp and paper companies showed that "companies within this industry face environmental risks that are of material significance and that vary widely in magnitude from firm to firm."[14] The report's purpose was to demonstrate a new methodology based on conventional business analysis techniques to evaluate the financial impact of environmental risks on the firm.
The report found that financial risk resulting from exposure to environmental issues identified would be more than 9 percent of share value for two companies, and less than one percent for three other companies in the group, the remainder falling in between. Three companies could expect a significant 10 percent impact on total market value, with the rest experiencing less variation one way or the other. Possibly most significant, the study found that only three companies mentioned *any* of the environmental issues analyzed in their most recent annual financial report, with all three only offering qualitative discussion.[15]

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[11] Justice K. Peter Richard, *The Westray Story: A Predictable Path to Disaster* (Province of Nova Scotia: November 1997).

[12] W. Gary Simpson & Theodor Kohers, "The Link Between Corporate Social and Financial Performance: Evidence from the Banking Industry (2002) 35 *Journal of Business Ethics* 97-109 at 104.

[13] The twelve assessment factors utilized by the *CRA* include: (1) Communication with members of the community to ascertain credit needs, (2) Extent of involvement by the board of directors with CRA activities, (3) Marketing efforts to make the types of credit offered known in the community, (4) The extent of loans originated in the community, (5) The extent of bank participation in government loan programs, (6) The geographic distribution of credit applications, approvals, and denials, (7) The record of branch office openings and closings and extent of service provided at the offices, (8) Practices to discourage credit applications, (9) Discriminatory or other illegal practices, (10) Participation in community development projects or programs, (11) The institution's ability to meet community credit needs, and (12) Other relevant factors which could bear upon the extent to which the institution is helping to meet the credit needs of the community.

[14] Robert Repetto & Duncan Austin, *Pure Profit: The Financial Implications of Environmental Performance* (Washington D.C.: World Resources Institute, 2000) at ix [herinafter "*Pure Profit*"].

[15] Pure Profit at xi.