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Corporate Knights

2010 RESPONSIBLE INVESTING
GUIDE



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8th annual

RESPONSIBLE INVESTING

Guide

Open Season

by MELISSA SHIN with files from TOBY HEAPS

WEARY FROM THE ROLLER
COASTER RIDE OF THE LAST
DECADE, RESPONSIBLE INVESTORS
ARE DEMANDING GREATER
TRANSPARENCY AND DISCLOSURE
AS WE RECOVER FROM A GLOBAL
RECESSION. THE WORLD'S DECISION
MAKERS ARE STARTING TO LISTEN

In November 2009 at an event called "Sustainable Stock Exchanges" at UN headquarters, 100 top executives explored how the world's exchanges can enhance corporate transparency, and ultimately performance, on environmental, social, and corporate governance (ESG) issues.

"Globally, there's a greater interest from investors in active engagement with companies in their portfolios," says Will Oulton, head of FTSE's Responsible Investment Unit. "The UN Principles for Responsible Investing (UNPRI) [and other initiatives] have driven the view that you can't be an absentee landlord with your investments."

Oulton says that enhanced disclosure is essential for engaging investors. "There is a greater appetite for ESG information, particularly carbon and environmental-related information," he says.

And that information is becoming easier to find.

The end of the decade saw the mainstreaming of ESG metrics by financial data behemoths, thanks to Thomson Reuters' acquisition of ESG data provider ASSET4, and Bloomberg's move to make ESG data

available on its 250,000 data terminals. What gets measured and published matters, so this is a game changer.

In November 2009, the Carbon Disclosure Project, backed by investors controlling \$55 trillion, launched a Water Disclosure questionnaire, which will be sent this year to 300 companies in water-intensive industries. Meanwhile, others are tackling energy efficiency as a financial competence issue: Mercer and Ceres released a report in December 2009 showing that it enhances value in real estate portfolios. This gathering consensus, coupled with rising energy prices, will force major pension funds like our own \$123.8 billion Canadian Pension Plan to pursue no-brainer, multi-million-dollar-saving energy efficiency measures—or risk violating their fiduciary duty.

It's not just environmental issues that are becoming more material. Former Canadian Prime Minister Kim Campbell sits on the board of the Women's Leadership fund, which invests in publicly listed companies that have a high number of women in senior posts. Naissance Capital, the firm who manages the fund, has found gender diversity to be the most influential governance-related

determinant of higher return on equity.

What tipped the balance in favour of mainstream success? The past few years have seen development in green sectors progress at a fever pitch. In 2008, renewable energies overtook fossil fuels in attracting investment for power generation. And in the third quarter of 2009, cleantech surpassed biotech and IT as the top venture capital investment category in the world, representing \$1.59 billion across 134 companies. Add to that the almost half trillion dollars worldwide allocated to green stimulus that will be doled out over the next two years, and it's clear that green-chip companies will be riding a powerful wave.

Despite the growing importance of sustainability to the corporate world, there is still a lack of hard ESG data from most listed companies, so investors don't have the information they need. "This failure is slowing the development of analysis and practice on responsible investment, and represents a significant barrier to the integration of ESG issues into mainstream investing," writes Social Investment Organization Executive Director Eugene Ellmen in a November 2009 paper.

In response to an investor transparency private member's resolution put forward by Ontario MPP Laurel Broten in April 2009, the Ontario Securities Commission (OSC) held consultations—in which Corporate Knights participated—and subsequently announced its plans to enhance corporate governance and environmental disclosure requirements for reporting companies. Also spurred by Minister Broten's resolution, the Hennick Centre for Business and Law at York University is currently undertaking a review of disclosure requirements for social matters and will report to the Minister of Finance. The OSC will develop guidelines on improving company disclosure in time for preparing 2010 annual reports.

RESPONSIBLE RETURNS

CK's ranked Responsible Investment (RI) funds range from climate-focused, to ethically-focused, to community values-oriented. While this diversity gives investors choice, Nick Robins, head of HSBC's Climate Change Centre of Excellence, and Cary Krosinsky, Vice President of Trucost, argue in their book *Sustainable Investing* that responsible investing has become too generic and puts too many factors in bed together. Up until recently, few funds had an explicit ESG mandate, so the tendency was to lump them all together—now, Robins and Krosinsky have found eleven categories of funds. Certain types of RI funds tend to outperform the average RI fund and the market by a substantial margin. "These funds are more likely to

anticipate what's going to happen to companies in the future," Robins says. In our ranking, funds solely focused on environmentally-oriented companies (pure play funds) have financially outperformed our more broadly ESG-mandated ones.

THE RULES OF ENGAGEMENT

Our average CK Social Score (CKSS) rose this year from 51.6 in 2009 to 55.41. However, our average "engagement impact" score (see methodology on page 44) fell from 44.83 in 2009 to 42.3 in 2010. Despite that, there were positive changes that came from our top fund companies:

- Northwest & Ethical Investments (NEI) encouraged TELUS, Research In Motion, and Rogers to adopt stronger supply chain codes of conduct. Canadian retailer Le Chateau now discloses its supply code of conduct, and Goldcorp agreed to issue a 2009 Human Rights Impact Assessment for its Marlin mine in Guatemala.
- Inhance Investment Management, a subsidiary of Vancity, obtained commitments from BMO and TD to assess the risks of financial instruments derived from greenhouse gas trading.

"YOU CAN'T BE AN ABSENTEE LANDLORD
WITH YOUR INVESTMENTS.

WILL OULTON, YOU'VE GOT TO BE AN ACTIVE PLAYER."
HEAD OF FTSE'S RESPONSIBLE INVESTMENT UNIT

A CRUDE JOB

Companies operating in the oil sands aren't doing enough to disclose material environmental, social, and governance issues that could threaten their long-term value, says a December 2009 report by Northwest & Ethical Investments.

In its study of 13 international public companies, *Lines in the Sands* examines exposure to risk on the themes of disclosure, Aboriginal engagement, climate change and air pollution, water, land use and biodiversity, and corporate strategy for change.

While the study found that Nexen, Suncor and ConocoPhillips stood out for the relative quality and completeness of their public disclosure, "in other cases even the most basic statistics were buried in obscure regulatory filings, amalgamated with other information, or simply not disclosed." Imperial Oil and Husky Energy, who did not participate in the study's survey component, "either did not consider the issues we raised to be material, or were unaware that their public disclosure did not contain the information we sought."

These systemic governance failures

extend to many other aspects of oil sands players' operations. Only a third of companies recognize treaty rights in their Aboriginal policies, and few base their consultation approaches on guidelines endorsed by Aboriginal communities themselves. Less than a quarter of companies disclosed any kind of water management targets, and only Suncor had absolute water use targets.

In its December 2009 Tailings Plan Review report, the Pembina Institute found only Suncor and Fort Hills Energy (now owned by Suncor) to be in compliance with the Alberta Energy Resources Conservation Board (ERCB)'s tailings performance criteria, Directive 074. When the Pembina Institute and Water Matters conducted a review of the tailings management plans submitted to the ERCB, they found that only two of nine projects would meet the requirements of the regulations to reduce toxic tailings starting in 2011. Some project proposals indicated they would not meet reductions until 2023, and would not meet rules for developing solid surfaces for over 40 years.

TMX Group and Finning International agreed to participate in the Carbon Disclosure Project, and CN and Research in Motion agreed to improve their sustainability disclosure.

- TDAssetManagement(TDAM) adopted and disclosed its Sustainable Investing Policy in April 2009, which includes its approach to being an actively-involved asset owner. In the past year, TDAM supported approximately 50 shareholder proposals at North American companies on a range of environmental and social issues. TD is also the only Big Five bank with a Chief Environment Officer.

- Inhance Investment Management, now wholly owned by Vancity, received a CKSS of 94.35, the highest of all fund companies. As of December 2009, Inhance and IA Clarington Investments entered into a long-term strategic relationship for the distribution of IA Clarington mutual funds through Vancity branches. This is significant, as IA Clarington's deep investment network will significantly increase the assets invested in Inhance funds.



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ALTERNATIVE INVESTING

We asked fund companies whether they invest in microfinance, community direct investment (CDI), or cleantech private equity. Meritas is the only mutual fund company in Canada to invest up to two per cent of its assets into CDI and microfinance. Inhance's parent company, Vancity, offers microfinance and CDI investments as separate products. Acuity invests in microfinance through international development bank bonds in its Social Values Balanced Fund, and was the only fund company in our report to invest in private cleantech companies through its Clean Environment Fund.

LONG-TERM PROOF

Portfolio managers who take the long view tend to have low turnover rates, which show what proportion of a portfolio's securities are being replaced with new ones in a given period of time. Turnover rates for the RI funds we ranked range from 0% (Meritas Money Market Fund, Meritas Balanced Portfolio Fund, and Alpha Social Values Portfolio Class A) to 143% (Mavrix Sierra Equity Fund). While growth funds typically have higher turnover rates, we still feel that a long-term growth manager should buy and hold, rather than try to time the market or use other practices that better belong in casinos.

ALIGNING INCENTIVES

Just four of the fifteen fund companies we looked at explicitly tie compensation levels with the degree to which fund managers incorporate ESG factors into the investment process: NEI (who also manages Desjardins' SocieTerra funds), Inhance, Mavrix, and TDAM.

VOTING WITH YOUR DOLLARS

We looked at funds' proxy voting records to ascertain which ones vote consistently with their stated ESG mandate. This year, NEI was the only fund company to have a 100 per cent ESG proxy voting record. ESG-related shareholder resolutions filed in 2009 included advisory and non-binding 'say-on-pay' votes on executive compensation (most funds voted in favour), and

THE 50 MILE PORTFOLIO

Inspired by the Slow Food movement, venture capitalist-turned-"nurture capitalist" Woody Tasch believes that "Slow Money" enhances food security, improve nutrition, and promotes cultural, ecological, and economic diversity. The Slow Money movement encourages investing in assets within 50 miles of where you live, such as local farms, and prioritizing community and environmental issues. "What if, instead of making a double-digit return on a fast-money transaction that exploited Third World villagers and pumped up corporate profits artificially," Tasch says, "you could get a steady two to three per cent return on money that dramatically improved the quality of life in your own neighborhood?"

COUNTING CARBON


According to a report compiled by Trucost, America's largest mutual funds (over 90 funds worth \$1.5 trillion) have a carbon footprint of 615 million tonnes CO₂e—almost ten per cent of the USA's 7.2 billion tonnes of annual GHG emissions. Four of the five least carbon-intensive funds were sector-based investment funds that did not invest in carbon-intensive sectors such as utilities or oil and gas.

Interestingly, an RI fund, the Sentinel Sustainable Core Opportunities Fund, was among the most carbon-intensive. This fund had a larger-than-typical proportion of investments in utilities and agriculture. Trucost's Cary Krosinsky explained that some RI funds only look at one side of the SRI spectrum, such as social issues, and ignore others, such as environmental implications.

The most carbon-intensive fund tested was the iShares FTSE/Xinhua China 25 Index Fund, which invests in coal-fired utilities in China.

and independence of compensation committees and advisors (ESG-focused firms tended to vote in favour and traditional firms tended to vote against).

RBC was the only ESG fund to vote against:

- At Enbridge's AGM, a shareholder proposal asking for a report on the impact of Enbridge's Gateway pipeline project (filed by the Dogwood Initiative, 11.09 per cent were in favour), and a proposal asking for a report on prior consent for new projects from Aboriginal communities (filed by NEI, 32.55 per cent were in favour)
- At Barrick Gold's AGM, a shareholder proposal asking for a review of the company's compliance with Community Engagement and Sustainable Development guidelines. 

Melissa Shin is the Managing Editor of Corporate Knights.

	SCORE OUT OF:	IA CLARINGTON
ENGAGEMENT IMPACT: Please provide up to the three biggest ESG impacts your engagement policy produced in the most recent year	4	4
Have you participated in any collaborative engagement or shareholder initiatives (Do not include shareholder resolutions you have led)?	2	2
Do you have an active ownership policy for engaging companies you own?	1	1
Do you allow companies to see their ESG profiles?	1	1
INTEGRATION: How do you obtain ESG information about companies?	3	3
Do you have an ESG screening policy (positive/negative) and how do you ensure it is applied (Please provide example(s) where ESG issues drove a buy or sell decision)?	4	3.5
Do you invest in any Community Direct Investments, Cleantech Private Equity or Microfinance products?	3	2.25
Have your investment managers been trained on applying ESG criteria to investment decisions?	1	1
Have you requested any information regarding ESG issues from any companies that you own in your portfolio/funds?	1	1
Have you aligned your compensation incentive structures to incorporate any of the ESG related issues?	1	1
Does fund have regular external controls in place to assess quality of ESG?	1	1
Do you allow unitholders to have input on your ESG focus?	1	1
SYSTEMIC: Have you participated in the development of any public policy, regulation, or standard setting around ESG issues in the past year?	3	2.5
Have you published or provided financial or other support towards academic or other research into ESG issues?	2	2
Do you support the development of tools for benchmarking ESG integration into the investment process?	1	1
BONUS: What do you do to minimize the environmental footprint of your mail correspondence with unitholders?	1	2
CKSS		94.35

IA CLARINGTON'S CORPORATE KNIGHTS SOCIAL SCORE (CKSS)

The Inhance IA Clarington funds had the highest CKSS of all Responsible Investing funds examined by Corporate Knights. This was due to its active ownership policy—Inhance engaged with 19 companies on 25 points of engagement between November 2008 and November 2009—integration of ESG into fund management practices, and commitment to advocating for increased ESG disclosure. The company also voted 93 per cent of the time in favour of ESG-related shareholder resolutions*.

IA Clarington's score is based on data from Inhance Investment Management, a wholly-owned subsidiary of Vancity, provided for the period ended November 30, 2009.

**Using the SHARE database of proxy voting records, we looked at all the ESG-related shareholder resolutions brought forth at company AGMs that received more than 7.5 per cent of the votes (29 resolutions in total). These resolutions were cross-referenced with the holdings in each mutual fund. If funds held less than 15 per cent of these companies, they were not included in assessment.*

**TOTAL
ENGAGEMENT SCORE**
90.82%

**TOTAL
INTEGRATION SCORE**
91.67%

**TOTAL SYSTEMIC
SCORE (WITH BONUS)**
107.14%