



(Final copy)

Institutional Investors: Do We Act Like Owners?

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Introduction

On this beautiful day in Halifax, good morning. Thank you Ray for a most generous introduction. Assets were \$70 billion. Clearly written questions. Today I am in front of you because Ray Koskie asked me to say a few words on a topic that I care passionately about – making sure we do our job as fiduciaries.

I am here to convince you on the idea of working together to improve corporate governance and therefore the Canadian economy.

I am also here to hear Bill Lerach describe the remedies available to institutional investors if all else fails.

Together we can make our little corner of the world better and an organization like the International Foundation has a big role to play.

The title – Institutional Investors – Do We Act Like Owners? Or is this mess not partly our fault?

I'll cover the following topics:

- ? Study of pension funds by two anthropologists
- ? Myners Report
- ? Need for better laws and better enforcement of our laws
- ? The Canadian Coalition for Good Governance and
- ? Institutional investors – as owners

First, I would like to cover two studies that demonstrate the need to make sure our own governance is in order before we attempt to improve the governance of corporations.

Slide 1

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|---------------------|
| ? Conley/O'Barr |
| ? Fortune & Folly |
| ? 6 corporate plans |
| ? 3 public plans |

To understand how we institutional investors behave, I went back in time and re-read Fortune and Folly written by John Conley/William O'Barr, and published in 1992 (Business One Irwin).

- ? What did they find when they studied 6 corporate/3 public pension funds in the US?

Slide 2

Findings:

- ? **Political battles**
- ? **Personal disputes**
- ? **History**
- ? **Shift of responsibility**
- ? **Focus: short term**

- ? Conley and O'Barr are anthropologists – they were trained to watch and listen.
- ? Their expectations were that fund managers would account for strategy and structure in economic terms.
- ? The reality was different. The fund managers they observed, in a word – us - speak of:
 - Political battles
 - Personal disputes
 - Quirks of history
- ? It was striking to them, the extent fund managers did not offer economic explanation for the ways they manage money. They believe in policy but describe evolution rather than planning.
- ? For public funds, culture drives decision making as much as finance, and clearly there is a civil service mentality.
- ? In most of these funds there is:
 - A great ability to shift responsibility from identifiable individuals . This applies at the board or trustee level where consultants are hired to advise the board to make sure management and its consultants are doing things right. But are the right actions taken you might ask.
 - The desire to displace responsibility and blame is always present.
- ? When looking at private fund, executives invoke ERISA as a force absolving them of responsibility for critical decisions.

Everyone denies a short-term myopia but executives delude themselves; every discourse is focused on the short term.

From this study done a decade ago, we can conclude that our own governance is in need of repair.

A very interesting blueprint for good pension governance was published by the Pension Investment Association of Canada (PIAC) in early 1997. All of us should look at its recommendations.

Institutional investors are not supposed to be emotional – they are supposed to have a plan and to follow it.

But I always like to remind myself that.

In 1971, before the US market crashed by 40%, 122% of the cash flow of pension funds went into equities.

On the other hand, in 1974, while there was a sale in equities, 21% of the cash flow was invested in that asset class.

In the end who is responsible?

- ? Consultants
- ? Management
- ? Board

Re-read Conley and O'Barr and ask yourself: what are the implications for pension governance.

Slide 3

Myners Report – Why	
?	Understand national competitiveness
?	% of assets in V.C. and PE versus US
?	Are decisions made rationally

The second study I would like to cover is a more recent one and it speaks of our governance... although that was not its original purpose. The original purpose was to find out why only a very small portion of the assets of British institutional investors are invested in venture capital or private equity.

This report is the work of one person – Paul Myners, ex-CEO of Gartmore Investment. Many of you may be familiar with it – or even have read it from cover to cover. If you have, you will agree with me that if you change the spelling of a few words, presto – the report applies to Canada.

? Some of Myners' conclusions:

- Trustees:
 - . 62% have no qualifications in finance or investment
 - . more than 50% receive less than 3-days training
 - . 50% spend less than 3 hours preparing for a meeting
- Of the 50% that had training, who were not financially literate, this training was the only training they had.
- In preparing his report, Myners interviewed many trustees, they were asked the question "if interest rates go up..... what happens to the price of a bond?" 32% of them got the wrong answer or were not sure of the answer.

Luckily, he did not ask them to compare the duration of the assets and the liabilities of their pension fund – or to describe value at risk.

Here are some recommendations from Mr. Myners – many of them would apply here in Canada:

- ? There should be a legal requirement that where trustees take a decision, they should take it with the skill and care of someone familiar with the issues concerned as opposed to the skill of an ordinary man of business.
- ? Trustees should assess the effectiveness of their own contributions to meeting the objectives of the fund.

The next one is a steal from the U.S. regulations under ERISA.

- ? In voting proxies, the responsible fiduciary should not subordinate the interests of the participants and beneficiaries to unrelated objectives on soft \$.
- ? Management fees should be inclusive of any external research, information or transaction services (ie, commissions).

All in all, this is a very good report. It has over 50 recommendations, many of them are of minor importance but nevertheless well worth reading for anyone involved with pensions.

By now, I hope I have your attention on the issue of governance because we as institutional investors must do a better job on our own governance.

All corporate plan trustees must remind themselves that they are there to represent the members. The same applies to jointly trusted plans where too often the representatives of the workers generally have white hair and think more of improving benefits than in developing sound funding management policy.

Slide 4

Canadian Coalition for Good Governance			
?	When	–	June 2002
?	Why	–	focus governance
?	Who	–	12 funds/investment managers
?	How	–	work with boards – not against
?	What	–	performance
?	claudel@otpp.com or grace_hession@otpp.com		

Now that we know we can and must improve, we can talk about the necessity for improvements in the governance of the corporations in which we invest – and, unless you have lived on Mars, I do not have to convince you of this need.

Early in June, Stephen Jarislowsky called me to express his frustration about the weak representation that investors have on boards.

We talked about a number of things we could do together – ie, Jarislowsky Fraser and Ontario Teachers'. But the more we talked about it the more we were attracted to the idea of getting other funds and managers involved.

We sent an invitation to 47 organizations. At the first meeting on June 20th, 21 came in person or by phone.

Why, you may ask do we need a new organization? In part, because many of the other pension organizations have too broad a mandate and have members who have divergent interest when it comes to governance.

The Canadian Coalition for Good Governance is a loose group whose members will not always agree on all issues. However, all agree that the coalition has a clear mandate to improve corporate governance and the legal framework within which corporations function.

What is interesting is that a number of the funds that attended the meeting and agreed with our aim decided to be observers when we decided to send a press release announcing the formation of the coalition.

The brave organizations that were ready to have their name associated with this effort are: Altamira, Beutel Goodman, Burgundy, Knight Bain, MacKenzie, ManuLife, Franklin Templeton, OMERS, Standard Life and two associations, The Investment Counsellors Association of Canada and PIAC.

Do you want to know what is really rewarding... Stephen and I were skeptical we could attract many investment counselors. You will note that out of the 11 money managers that are involved, when you add Jarislowsky Fraser and my own organization, 9 out of 11 are counselors.

We have had inquiries from many other institutional investors and hopefully a number of them will join. Many funds did not have a policy in place and management had to check with their board before having their name associated with our effort. This also tells you that many boards had never discussed the topic at hand or never reached a conclusion.

But now that we are out and running we are really interested in enlarging our group. We want your organization to join the coalition. That is why you can read my email address at the bottom of the slide... and the one of Grace Hession, who, with Trevor Apperley, coordinate this effort for Teachers'.

Send a note to Grace or myself if you want to join or be on our distribution list and conference calls.

How do we want to proceed. First of all this is a group that will work with boards not against them. We need great corporations in this country and we need more of them. We also need boards that represent us as owners. And, finally, we need to act as owners.

Our goals are to:

1. Monitor the performance of boards.
2. Insist that the key committees have a majority of independent directors.
3. Share information on good candidates to represent us and talk with nominating committees. We need to be more involved in the selection of directors who represent us, the owners.
4. Suggest compensation schemes that reward employees for sustained performance.
5. Develop a common position on accounting standards and financial disclosure.
6. Work with the Securities Commission to strengthen regulations and penalties.

You might say that this is a large agenda. We do not think so. This is an agenda that each owner of shares should have in mind when investing.

What do we expect to get?

Governance, we all recognize, is a mean to an end.

What are we after?

We are after performance. All of us are convinced that good governance is an essential element to boost performance.

We also think that there are laws that can be made more shareholder friendly. For instance, in Ontario the government is reviewing all the securities laws. This is the first comprehensive review in 30 years when securities laws were first implemented in Ontario. We think all investors should be involved in this review, and we will be.

Slide 5

Ontario Securities Laws:	
? Report tabled	
? On the web: www.osc.gov.on.ca	
- Laws	} Investor Friendly
- Regulations	
- Enforcement	

This is an opportunity to make a difference. The province of Ontario, who is the best staffed when it comes to security regulations, has started a process called the 5-Year Review of the Ontario Securities Laws. Every institutional investor should make sure that their views are expressed and that the penalties for transgression are strengthened.

So that we do not have cases like the one of the ex-CEO of one of our high-tech companies that was asked to pay a penalty of 20% of the profits made through insider trading.

You have until August 15 to send your comments.

On the other hand, the recent scandals in terms of improving regulations in Canada and making rules more uniform can be seen as an opportunity to make changes. Now I would like to move away from Ontario.

Our Securities Commissions, the security regulators in Canada, are organs of each province.

We have 13 agencies that regulate securities. Most of these are not well-staffed and by that I mean both in qualitative and quantitative terms. This would be bad enough in a static industry but for one in constant evolution it is far from adequate.

Slide 6

Securities Commissions:	
? Generally weak staff	
? Turnover	
? Enforcement – poor	
? Source of revenues for provinces	
? Commerce not high on agenda	

Our laws are ok but the enforcement is not rigorous. A few years ago, the Globe had a series of articles on the topic of security regulations.

One of the articles had over 25 graphs where one could see that there was probably some sort of insider trading that had taken place. How many of these cases were prosecuted? To my knowledge, there were none.

As John Kazanjian of Osler, Hoskin's pointed out in the August 2 edition of the Financial Post "For Canada's largest companies, the US appears to have resolved the long-standing Canadian debate about not having a national securities regulator. It's Harvey Pitt's Securities and Exchange Commission."

My plea to you for the members you represent is to make sure that your voice is heard and that securities laws and regulations reflect what the owners want, need and deserve. The Coalition will send its own comments to the Ontario government – again, you can go along with us or you can and should send your own comments. And even more important, make sure that the laws in your own province are shareholder-friendly.

Institutional Investors

Slide 7

- ? **Doing enough??**
 - **Our own governance**
 - **Governance of investee corporation**
- ? **Vote proxies**
- ? **Monitor outside managers**
- ? **Lobby:**
 - **Accounting organizations**
 - **Government**
 - **Corporations**
- ? **Talk to other funds**

Now we come to a different issue – are we, as institutional investors, doing enough to improve governance. As I have mentioned earlier, you have to ask if we are doing enough to improve our own governance. As Matthew states (in Chapter 7:3-5) "*Why do you look at the speck of sawdust in your brother's eye and pay no attention to the plank in your own eye.*"

Let's concentrate on the issue at hand – what can we do as institutional investors.

Let's start with an easy one – does your fund vote the proxies that it owns or does it make sure that these are voted by your external manager. A study by Fairvest tells us that roughly 60% of the proxies are voted in Canada... and the same study also tells us that the more controversial the issue the lower the percentage voting.

At Ontario Teachers', since the days of our entry in the market in the early '90s, we have given our board a report on how we have voted our proxies... and in 2001, we started to show on our web site how we have voted each proxy... we also give a reason when we vote against a proposal.

When it comes to voting by outside managers, they should follow instructions from their clients – but the client has to monitor that the voting takes place, according to its instruction. Most managers have a conflict... they may manage money for the company who is not focused on delivering returns to their owners.

How many funds, directly or through an industry association, are involved in lobbying to try to improve:

- ? The accounting standards that exist... after all, we are the people who need and rely on annual reports
- ? The laws that regulate corporations... it is amazing how friendly they are to the corporations. When the Allen Committee in Ontario recommended continuous disclosure... this would have been very useful to investors. How many investors took the time to write to the government to support this proposed initiative.

I can tell you that some of our largest corporations lobbied with our own money against this proposal.

- ? Finally, how many funds take the time to write directly or through their fund managers to the board of a corporation... when the reporting is not first class or the option program is too generous. Too many of us are waiting for someone else to do the dirty work.

We have to remember that board members - like politicians – are influenced by the number of letters... as well as by how many shares a fund owns. Personally, I think a small fund can have as much influence as a large one.

Slide 8

- | |
|-----------------------------|
| ? Better laws |
| ? Better enforcement |
| ? Better staffing |
| ? Vote proxies |
| ? Write to Boards |

Therefore, it is easy to see that institutional investors have to be more involved. More involved in what, you may ask. Here are my suggestions.

Make sure that your legislature enacts better laws to supervise the securities industry.

Write to the regulators and your representative to ensure better enforcement of the laws that are on the books. In fact, if the legislators do not want to spend the amount needed for rigorous enforcements, laws should be such that investors should be able through a class-action or individually to pursue remedies in court. In a few moments you will hear Bill Lerach talk about this topic.

Make sure your proxies are voted. This is one of the inexpensive ways you can let the board members who represent the shareholders know how you feel about how the affairs of the corporation are being run.

One of the main issues with shareholders' resolutions is that after they are passed at the Annual General Meeting, many of them are never implemented. For instance, in the US of the shareholders' resolutions passed in 2001, 70% are still not implemented one year later.

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? **ACT LIKE AN OWNER**

The most important lessons from the events of the last 18 months are that institutional investors need to act like owners. You have seen or heard this recommendation very often lately.

Even Fortune magazine in its issue of June 24, offers as one of its seven reforms to change the system "shareholders should act like owners" and the magazine continues "in the US, 75 institutions control \$6.3 trillion worth of stock or 44% of the market".

The problem starts in this room. You have to ask yourself is my fund acting like an owner. Am I investing the funds under my responsibility in the best interest of plan members.

How do you do that – one way is by talking to other shareholders and working together. But you have to be careful because in most provinces it is still illegal for two shareholders to talk together about how they will vote their proxies without making an expensive and time-consuming filing for a dissident shareholder proxy circular, but there has never been a court case on this to my knowledge.

At the federal level the law was amended 18 months ago, and now permits us to talk to 15 shareholders. You have to wonder why there is a limit of 15, who imposed it, we never talked about any limit when I testified in front of the Senate on this. And, if the worry was that large shareholders could benefit at the expense of small ones, penalties should have been imposed for oppressing other shareholders.

But you can be sure that many corporations were working behind the scenes to limit the ability of shareholders to act like owners.

There is strength in numbers. That is why the Canadian Coalition for Good Governance wants to help in meeting our fiduciary duties. Together we can talk to our representative board members, we can help them.

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Work together:

- ? **Canadian Coalition for Good Governance (CCGG)**
- ? **Institutional Shareholder Services (ISS)**
- ? **International Corporate Governance Network (ICGN)**

We have to write to boards when corporations use our money to lobby against our interests.

We have to lobby government on issues that affect the values of the corporations that we own.

If you plan to invest outside of Canada you have a duty to be involved. How many Canadian funds invest outside of North America. I will dare to say most of them. How many are members of an organization like the ICGN (the International Corporate Governance Network). This organization is devoted to improving governance internationally.

Go to the ICGN web site. This year it published papers on important topics like cross-border voting and the problems involved in voting ADR, and it also published a great paper on executive remuneration.

Each one of us has to be involved.

We are the owners of these corporations and we have to start acting like owners.

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? **ACT LIKE AN OWNER**

Thank you.