

## Studies show strength in governance

### Income fund governance practices compare favourably with those of public corporations

By Stephen Pincus & Jennifer Sernaker

The increased scrutiny of corporate governance practices both in Canada and around the globe has not overlooked the Canadian income fund sector. And given its dramatic growth this decade, the sector has attracted much attention from the marketplace and analysts, both legal and financial, with respect to prevailing governance practices. Two recent research initiatives examining the topic in relation to legislative and regulatory guidelines confirm, to the sector's benefit, that Canadian income fund governance compares favourably with corporations and is generally compliant.

In 2005, Industry Canada retained Goodmans LLP to examine the governance protections afforded to unitholders pursuant to Canadian income fund declarations of trust (DOT) compared with those of shareholders under the Canada Business Corporations Act. Goodmans was asked to consider provisions relating to the duties and liabilities of trustees, disclosure and communication with unitholders, and rights and remedies of unitholders. The study compared 20 key provisions of each DOT with the corresponding provisions of the CBCA to see whether or not the DOT provided protection to unitholders that was superior or roughly similar to protection provided to shareholders of a publicly traded CBCA firm.

The study found the vast majority of DOTs examined have provisions superior to or substantially similar to most of the CBCA provisions considered. The main differences between the CBCA provisions and the DOTs in the sample — a random selection of 54 publicly traded funds of varying sizes from each industry sector — relate to unitholder rights and remedies.

Income fund DOTs do not generally provide equivalents to the CBCA shareholder rights and remedies of shareholder proposals, oppression, dissent rights and derivative actions. This fact is addressed by the **Canadian Securities Administrators'** National Policy 41-201, *Income Trusts and Other Indirect Offerings*, adopted in December 2004, which recommends income funds disclose that a unitholder may not be afforded the same protections, rights and remedies as a shareholder in a corporation.

Although the mandate of the Goodmans study was limited to comparing certain provisions of DOTs with corresponding or similar CBCA provisions, securities regulatory instruments and policies generally impose the same governance requirements on both income fund and corporate issuers. These instruments and policies are the focus of another recent study on income fund governance.

The **Canadian Association of Income Funds** and the Real Property Association of Canada recently retained one of Canada's largest independent strategy consultancies, SECOR Consulting, to perform a study comparing the income fund and public corporation compliance with the governance guidelines established by the CSA.

The SECOR study assessed 202 income funds and compared them with a representative sample of **Toronto Stock Exchange**-listed companies based on their respective compliance with the governance guidelines set out in National Policy 58-201, which focuses on core governance issues relating to board composition, structure and operation. That study, made public last month, was based on publicly available information disclosed as of July 31, 2005.

In certain circumstances, SECOR analysed the composition and activities of the board of an entity underlying an income fund. On average, the income funds surveyed were four years old, while approximately 75% of the funds analysed were less than five years old, and almost two-thirds were categorized as specialty business funds.

SECOR found that income funds generally compare favourably with public companies: 67% of funds are explicitly compliant with more than 90% of the guidelines, compared with 71% of public companies. In particular, SECOR found that income funds demonstrate board independence across a number of factors. For example, the average number of unrelated directors on income fund boards is five out of an average total of seven directors, which is similar to public company boards, with an average of six unrelated directors out of eight. SECOR also found that income fund boards generally play a significant role in developing roles and structure.

These studies suggest income funds compare favourably with public corporations in areas of governance in which the two are readily comparable. However, there are a number of areas in which income funds raise unique governance issues. These areas will no doubt be the focus of study within the income fund sector in the near future.

Meanwhile, Goodmans is currently publishing its second edition of *Income Funds in Perspective*, which contains a more detailed look at these two studies, as well as discussion of other income fund developments that occurred during 2005. **IE**

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