



Shareholder Association
for Research and Education

May 31, 2004

VIA EMAIL

Alberta Securities Commission
Saskatchewan Securities Commission
Manitoba Securities Commission
Ontario Securities Commission
Nova Scotia Securities Commission
Securities Administration Branch, New Brunswick
Office of the Attorney General, Prince Edward Island
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Government of Yukon
Registrar of Securities, Department of Justice, Government of Northwest Territories
Registrar of Securities, Legal Registrars Division, Department of Justice, Government of Nunavut

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8
Fax: (416) 593-2318
Email: jstevenson@osc.gov.on.ca

Dear Sirs and Mesdames:

Re: Proposed Multilateral Policy 58-201 *Effective Corporate Governance* and Proposed Multilateral Instrument 58-101 *Disclosure of Corporate Governance Practices*, Form 58-101F1 and Form 58-101F2

The Shareholder Association for Research and Education (SHARE) is pleased to provide comment on the proposed Multilateral Policy 58-201 *Effective Corporate Governance* and proposed Multilateral Instrument 58-101 *Disclosure of Corporate Governance Practices*, Form 58-101F1 and Form 58-101F2 (the "Proposed Policy").

SHARE is a national organization that supports responsible investment practices and governance by pension plans through education, research and advocacy. Our affiliate pension plans represent total assets of more than \$10 billion.

1. GENERAL COMMENTS

SHARE commends the members of the CSA for their ongoing efforts to develop a much-needed framework for corporate governance in Canada. It is clear that the issue of governance is not a fleeting concern for capital market participants. The observed impacts of poor governance on markets and the larger economy demonstrate the need for leadership and clarity in this area in order to provide direction to issuers, confidence to investors, and accountability to society at large. As asserted by the Ethics Practitioners' Association of Canada in its submission, corporations have been given special advantages in our society and should therefore be accountable to society for their actions.

The following submission addresses most of the aspects of the Proposed Policy with reference to submissions made by other stakeholders to date where applicable. While SHARE applauds the CSA's leadership in strengthening corporate governance practices in Canada, the Proposed Policy falls short of what is required to meet the demands of investors and to ensure that Canada remains an attractive market for investors in the long-term. Specifically, SHARE submits the following general principles must guide the development of the Proposed Policy:

- Disclosure is an important requirement, but insufficient to provide address investor concerns. Investors currently have little ability to influence corporate governance practices and for smaller investors, little means to engage corporations. Accordingly, as recommended by the Institute of Internal Auditors and the Association of Investment Management and Research, the Proposed Policy should stipulate minimum mandatory standards for each governance practice in addition to advocating the application of a principles-based approach to guide issuers in exceeding minimum requirements.
- As recommended by the Ethics Practitioners' Association of Canada, minimum standards should accord with international standards and global conventions.
- A more expansive treatment of corporate governance is required that goes beyond legal compliance taking an investor-focused approach and including consideration of non-financial dimensions of corporate practice (i.e. corporate social responsibility).
- As suggested by the Institute of Internal Auditors, be explicit about the degree of disclosure expected for each governance practice, including details on monitoring, assessment and feedback.
- Require governance information be reported in the issuer's proxy circular, not the AIF.

The remainder of this submission applies these general principles with respect to each issue raised in the Proposed Policy as well as other governance practices which we submit should be addressed. Time has prevented a detailed review of the arguments supporting our position on these matters. SHARE refers the Commissions to our previous submissions on NI51-102 for further argument.

2. INDEPENDENCE STANDARD

Independence is not an absolute concept. Accordingly, SHARE supports the application of a subjective definition of "independence" supported by minimum mandatory independence standards. SHARE recommends that the definition of independence applied in the Proposed Policy be strengthened beyond the definition provided in Multilateral Instrument 52-110 *Audit Committees*. Specifically, a director should be deemed independent if he or she has no material relationship, other than that of director, with the company, its chair, CEO or any other executive officer. 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;
- 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. For example, in most cases a general partner exercises significant control over a partnership, while a limited partner may exercise significant control depending on the terms of the partnership agreement;

- 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. BOARD COMPOSITION

SHARE supports the requirements to disclose whether or not the chair of an issuer's board of directors is an independent director and to disclose whether or not a majority of directors are independent. However, as noted by the Association for Investment Management and Research, the Proposed Policy should also mandate these practices.

Accordingly, SHARE recommends that two-thirds of the board of directors should be independent as defined above. At a minimum, there should be a majority of independent directors on a board.

Similarly, SHARE submits that the Proposed Policy must require that the chair of the board of directors be an independent director. 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 who still receive consideration from the company, such as retirement benefits, and executives of client or vendor companies will also have a conflict of interest and should not serve as Chair.

We note that these requirements have been proposed by Industry Canada in its May 2004 discussion paper on proposed amendments to the *Canada Business Corporations Act* "Towards An Improved Standard of Corporate Governance for Federally Incorporated Companies".

In addition, SHARE submits that issuers continue to be required to identify by name those directors that the issuer deems to be independent pursuant to the definition in the Proposed Policy, not merely the total number of directors deemed independent. Further, where an individual director is deemed independent, the issuer should provide the basis upon which such determination is made.

Finally, in addition to disclosing whether or not independent directors hold separate, regularly scheduled meetings, issuers should be required to disclose the number of such meetings held annually and attendance records of the independent board members at such meetings.

4. BOARD MANDATE

SHARE submits that the board of directors should be required to draft a written mandate. This general statement is a basic component of a clear framework to guide directors and to inform investors about the orientation and priorities of the board of directors.

5. BOARD EDUCATION AND TRAINING

In order to be well qualified, directors should be knowledgeable in areas such as finance and accounting, executive compensation, and management. However, 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 training, such as social and environmental assessments of corporate operations. Even knowledgeable directors may find that they need additional training in order to guide the company effectively. Accordingly, SHARE supports the requirement for disclosure of measures taken to providing continuing education to corporate directors. We recommend that the Proposed Policy provide more guidance on the type of disclosure required in relation to director education about the nature and operation of the issuer's business, specifically training on the social, environmental and other non-financial dimensions of the business.

6. BOARD COMMITTEES

SHARE commends the CSA for introducing measures that will require issuers to disclose information with regards to an issuer's board nominating and compensation committees. The manner in which the disclosure requirements are worded implies support for certain minimum practice standards (e.g. committees composed entirely of independent board members). Again, these requirements should be mandated along with minimum process requirements addressing assessment and monitoring.

In response to other submissions made on this topic, we submit that the Proposed Policy should not treat reporting issuers differently. Investors need to be assured that all publicly listed firms in Canada meet the same standard of independence. Accordingly, closely-held firms will need to address the requirements by making the necessary adjustments to board composition, e.g. expanding the size of the board to meet the independence requirements.

Below we provide more specific comments with respect to the Proposed Policy and specific board committees.

6.1 Nomination of Directors

SHARE supports adoption of mandatory standards of independence for nominating committees in keeping with proposals recently put forward by Industry Canada.

Furthermore, we submit that creating an open, effective and credible nominating structure for reporting issuers requires that the Proposed Policy address the broader process for managing the nomination of directors.

With respect to disclosure, we recommend that reporting issuers be required to:

- Report on the specific process followed in determining director nominees by management and/or the board.
- Provide a detailed account of the process and reasons for nominating each director, and be strongly discouraged from using boilerplate statements in this regard.
- Disclose all the boards that a director sits on or has sat on during the past five years as part of allowing investors to assess a director's level of independence. (This recommendation is in keeping with recent shareholder proposals filed with Canadian companies that were accepted by management.)

In addition, we submit that policy governing the nomination of directors should extend beyond board nominating committees to provide a mechanism for investor input into the nomination process. We refer you to recent SEC proposals in that regard that would provide a realistic avenue for shareholders to nominate directors.

Beyond the nomination process, reporting issuers should be required to implement confidential proxy voting policies that help to alleviate the distortions in voting by money managers who may vote in favour of directors and against the interests of their investor clients in order to protect business interests.

6.2 Director Compensation

We make the identical recommendations with regards to expanded disclosure detailed under the section on Nomination of Directors above.

6.3 Governance Committee

From a governance perspective, directors play a critical role in setting policy and assessing and monitoring its implementation. This responsibility is of critical importance with regards to the nomination process and setting executive compensation, however it is also critical in terms of

setting firm governance policy and practice. The governance committee should have the independence to make decisions about the role of the management in board-level governance as well as overseeing the relationship between the board and management more generally. 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. At a minimum, SHARE recommends that the same disclosure requirements set out in the Proposed Policy with respect to nominating and compensation committees apply to board governance committees. We also concur with the recommendation of the Canadian Society of Corporate Secretaries recommendation that issuers be required to designate a chief governance officer from management and disclose this position to investors.

6.4 Environmental and Worker Health and Safety Committees

Recognition that the governance of Canadian issuers requires attention to the potential material risks and liabilities associated with a firm's operations, SHARE submits that good governance practices require that firms apply the same rigour to the governance of non-financial issues as investors are demanding with respect to financial matters. Investors require information to enable them to assess the potential long-term impacts resulting from poor governance of non-financial aspects of an issuer's operations. Accordingly, SHARE recommends that the Proposed Policy mandate similar disclosure requirements for reporting issuers with respect to board level environmental and worker health and safety committees. Specifically, an indication of whether such a committee exists, the degree of independence of the directors who sit on the committee, the text of the committee's charter, and individual director attendance records for the committee.

7. CODE OF BUSINESS CONDUCT AND ETHICS

In the current era of investor skepticism, it is necessary that all reporting issuers maintain a written code of business conduct and ethics, not only to reassure their investors, but to contribute to raising the credibility of the entire Canadian equity market that has long had a reputation amongst foreign investors for being wild and unpredictable. SHARE concurs with the views of other commentators, including Transparency International Canada Inc., the Association for Investment Management and Research, and the Canadian Investor Relations Institute, that a written code should be mandatory. Furthermore, we agree with the Canadian Society of Corporate Secretaries and the Ethics Practitioners' Association of Canada that no waivers should be permitted. A waiver could do more to harm investor confidence than having no code at all, by indicating that some within the firm are exempt from the standards of ethical conduct expected of others within the organization. At minimum, such waivers should not be at the discretion of the board. Rather an issuer should be required to apply for a waiver from the regulator.

SHARE endorses the submission of the Social Investment Organization on this topic, particularly reference to the items that should be required content in a mandatory Business Code.

Finally, SHARE supports an amendment to the Proposed Policy calling for disclosure of the findings of any compliance monitoring with respect to a reporting issuer's Business Code. As the KPMG survey cited by one commentator illustrates, companies may implement codes of conduct, however the rate of compliance is often very poor. Shareholders are entitled to know where an issuer has not complied with the terms of their Code.

8. BROADEN SCOPE OF CORPORATE GOVERNANCE TO INCLUDE SOCIAL AND ENVIRONMENTAL PRACTICES

The OECD Principles on Corporate Governance adopted earlier this year provide that with respect to corporate governance, disclosure should include, but not be limited to, material information on:

1. The financial and operating results of the company.
2. Company objectives.
3. Major share ownership and voting rights.
4. Remuneration policy for members of the board and key executives, and information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board.
5. Related party transactions.
6. Foreseeable risk factors.
7. Issues regarding employees and other stakeholders.
8. Governance structures and policies, in particular, the content of any corporate governance code or policy and the process by which it is implemented.

While the Proposed Policy and other existing directives pertaining to corporate governance go some way to satisfying these expectations, they remain limited. The issues of employees and other stakeholders and foreseeable risk factors are virtually ignored. The Proposed Policy must recognize the need of policy on corporate governance to address social and environmental corporate policy and practice. While some argue that the broad discussion of corporate governance principles captures these aspects, the fact is that few companies do address these issues in their consideration of corporate governance, and current policy does nothing to address this deficiency.

The time has come to require boards of directors of reporting issuers to be explicit about the policies and processes applied to address issues of social and environmental risk, including disclosure similar to proposed requirements in the UK, and minimum performance standards such as Regulation S-K in the United States. This incorporates financial and non-financial information for analysts and others evaluating firm performance, but is not intended to supplant separate social reporting that provides more detail to interested investors. All reporting issuers in Canada should be required to provide similar disclosures as part of their license to operate and in order to create a level playing field for all issuers (since some have taken proactive steps in this regard). International conventions and standards, such as Accountability (www.accountability.org.uk), The Global Compact (www.unglobalcompact.org), OECD Guidelines for Multinational Enterprises (www.oecd.org/daf/investment/guidelines), and the ILO Conventions (<http://www.ilo.org/public/english/standards/norm/whatare/fundam/>) provide internationally recognized benchmarks for reporting issuers to follow, and international reporting standards are being developed through the Global Reporting Initiative (www.globalreporting.org).

9. SHAREHOLDER RELATIONS

SHARE supports the recommendations of the Canadian Investor Relations Institute regarding improved access for investors to the board of directors. Similarly, SHARE commends to the CSA the findings of the US task force report on *Improving Board-Shareowner Relations* and the OECD Principles on Corporate Governance as a starting point for the investor relations elements that should be addressed in the Proposed Policy.

10. COMPLIANCE

Finally, SHARE supports the Canadian Society of Corporate Secretaries in recommending that the Proposed Policy detail the consequences resulting from a failure to comply with the Proposed Policy. Reporting issuers require explicit reference to the consequences to management and directors for a failure to comply, and investors need assurance that firms will comply with the Proposed Policy. The absence of penalties ensures that the policy will receive little attention from issuers and do little to bolster investor confidence.

We thank the respective Commissions for their efforts to involve stakeholders in the development of a new corporate governance framework in Canada. While we support the Proposed Policy, we urge the Commissions to incorporate mandatory minimum standards and expand disclosure to

include other internationally recognized dimensions of corporate governance. We look forward to the Commissions' consideration of our comments.

Yours truly,

Gil Yaron
Director of Law & Policy