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April 20, 2009

SENT VIA EMAIL

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Nova Scotia Securities Commission
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 the Northwest Territories
Registrar of Securities, Legal Registries Division, Department of Justice, Government of Nunavut

Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8

Re: Request for Comment: Proposed Repeal and Replacement of National Policy 58-201 *Corporate Governance Guidelines,* National Instrument 58-101 *Disclosure of Corporate Governance Practices*, and National Instrument 52-100 *Audit Committees* and Companion Policy 52-110 CP *Audit Committees* (the "Request for Comment")

We are pleased to provide our response to the Request for Comment referred to above.

General Comments

In this letter we have responded to the eleven specific issues raised by the Canadian Securities Administrators (the "CSA") in the Request for Comment. We would, however, like to note at

the outset that, while there are many positive aspects of the proposed revisions outlined in the Request for Comment, we do not believe that there will be sufficient benefit to the capital markets to warrant the time and resources required to implement the changes contemplated. Certainly at this point in time, issuers' resources are already taxed by the conversion to IFRS and by dealing with the uncertain economic climate.

However, even in more stable times, we do not believe that a change to a principles-based approach to governance would enhance standards of governance or the quality of governance disclosure. The concerns that we have in this regard are set out in more detail in the paper attached to this letter as Appendix A. We would recommend that the CSA not proceed with the changes set out in the Request for Comment. When the markets are calmer and issuers and investors have had an opportunity to reflect on governance practices and disclosure that would be most appropriate moving forward, we suggest that the results consultation process led by the private sector should inform any further proposals by the CSA in this area. Such a process would result in recommendations reflecting the practical governance issues facing boards and management and would result in greater acceptance of those changes by issuers and investors.

Specific Response

1. Do you think Principles 6, 7 and 9 provide useful and appropriate guidance? Does this guidance appropriately supplement other corporate law and securities law (including legislation and decisions of Canadian courts) relating to these areas?

The principles articulated in Principles 6, 7 and 9 are valid and already inform the governance practices of many well-governed companies. The drafting of these and certain sections needs further consideration, however. The examples we have set out below illustrate some of the major issues of concern.

Among the points that should be considered:

- If the CSA is intending to introduce a new legal concept, it should say that this is the case and explain the new concept (and we note it should exercise great discretion in doing so). If it is drawing on existing law, it should use existing terminology. The Commentary to Principle 6, for example, provides in part:

  > Conflicts of interest may arise in various situations, for example, when:
  >
  > ....
  >
  > (b) one or more directors cannot be considered impartial in connection with a proposed decision to be made by the board

  It is not clear what the CSA intends with the word "impartial". Corporate and securities law use the terms "interested director" and "conflicted director", but the term "impartial director" is not commonly used. Is this intended to establish a new standard of independence?

- In other cases, the choice of language seems out of place. All of the drafting needs to be reviewed with a view to what an issuer would do to give effect to the language chosen by the CSA. For example, the Commentary to Principle 9 recommends a voting process that

is "understandable, transparent and robust". It is not apparent what is meant by a "robust" voting process.

- Much of the drafting does not acknowledge the existing corporate law and has the potential of conflicting with it. For example, the Commentary to Principle 8 states that: "Compensation should be set and structured to attract and retain executive officers and directors and motivate them to act in the best interests of the issuer." Of course, officers and directors are required by law to act with a view to the best interests of the corporation, regardless of their compensation. We do not think it is advisable for the CSA to suggest that compensation should be the factor that motivates officers and directors to act in a manner that is consistent with their fiduciary duty.

- Some of the drafting also makes definitive statements of what boards should take into consideration that go far beyond what the courts have been prepared to say. For example, the Commentary to Principle 8 states that a board's approach to compensation should "include .... a balanced pursuit of the issuer's short-term and long-term objectives".

We do not think that issuers will derive much guidance from Principle 7. Risk (along with compensation) is the leading governance issue today. As discussed in the attached paper, it is not clear why the CSA is making definitive statements about specific risk management practices. For example, the Commentary states that: "Risk oversight and management is most effective if it is embedded into the issuer's practices and business processes rather than if it is viewed or practiced as a separate activity." The Commentary does not explain what it means to embed risk oversight and management in an issuer's practices and business processes or why this is a better practice than establishing risk management and oversight and management as a separate activity. While the point may well be valid, it does not seem that the CSA is the appropriate body to be developing guidance of this nature. This is one of several areas in which consultation with the private sector in the development of the principles, commentary and practices examples would be advisable.

2. Does the level of detail in the commentary and examples of practices successfully provide guidance to issuers and assistance to investors without appearing to establish "best practices"?

We do not share the CSA's concern about establishing governance standards that are generally accepted by the Canadian marketplace. Some refer to these as "best practices", but they can also be thought of as baseline standards. The current policy and instrument make very clear that issuers are not required to adopt those practices – if they choose not to, they need only disclose why they do not. If an issuer prefers to adopt every suggestion made by the CSA, then it is as likely to adopt the practice examples provided in the proposed amendments.

3. In your view, what are the relative merits of a principles-based approach for disclosure, compared to a "comply or explain" model?

The comply or explain model establishes minimum standards of governance that are widely seen as appropriate for most companies. The result has been that most issuers adopt those minimum standards. Where a practice is inappropriate (whether because of the size of the issuer or other

special circumstances), the issuer is free not to adopt the practice – but it must explain why it has not done so. This provides the reader with some basis on which to assess the issuer's practices.

On its face, the principles-based approach offers more flexibility for issuers to adopt the governance practices they feel are appropriate for them. This flexibility already exists in the current policy and instrument. If issuers are reluctant to stray from the recommended practices, but the CSA believes that issuers should be exercising more discretion, there are steps that the CSA could take to encourage issuers to do so. They could, for example, publish reviews of corporate governance disclosure showing examples of disclosure about practices that are different from those recommended by the CSA. Public support by the CSA for this type of disclosure would do a great deal to encourage other issuers to take similar action as appropriate.

We also believe that there are benefits to Canadian issuers in having practices recommended by the regulators that align with practices in the US. Standards established in the United States are the most commonly understood and accepted practices internationally. It is far easier for non-Canadian investors to become comfortable with the governance standards in Canada if they know that they aligned with the US requirements.

4. Is the level of disclosure required under each of the principles appropriate both from an issuer's and an investor's point of view? Specifically, do you think the disclosure in respect of Principles 6, 7 and 9 provides useful information to investors?

As noted elsewhere in this response, while much of the information required in the disclosure will be quite valuable, the loss of benchmarking against recommended practices will lend the disclosure far less to comparison as between issuers.

5. Should venture issuers be subject to the same disclosure requirements concerning their corporate governance practices as non-venture issuers?

Venture issuers should be subject to the same level of disclosure with respect to their corporate governance practices. Venture issuers need not adopt governance practices which they find too costly in comparison to the benefits derived or with which they simply cannot comply for a variety of valid reasons. But investors should know which practices they have adopted. Governance is a risk management tool and investors need to understand how it is being applied.

6. In your view, what are the relative merits of the proposed approach to independence compared to the current approach? In particular:

(a) basing the determination of independence on perception rather than expectation; and

(b) guiding the board through indicia rather than imposing bright line tests?

The main problem with the current approach to independence is that it catches relationships which do not in fact impair the independence of the director involved. This situation often arises because the activities of family members are relevant to the independence of the director. While it is possible to apply for relief in many cases, many issuers prefer not to make such an application and simply exclude the director in question from the audit committee. As a result,

directors who could make a valuable contribution to the audit committee are not appointed to that committee.

The proposed definition of independence speaks to the "relationship with the issuer, or an executive officer of the issuer, which could, in the view of the issuer's board of directors having regard to all relevant circumstances, be reasonably perceived to interfere with the exercise of his or her independent judgment". Perception of independence is certainly important because it speaks to the confidence that shareholders will have in the board and its committees. However, restricting independence to perceived independence is not sufficient. It should be clear that a lack of independence in fact (no matter how apparent – or "perceptible" – it may be) should exclude a director from the audit committee.

The indicia set out in the proposed Companion Policy would be helpful to boards in assessing independence. Cross-listed issuers would also refer to the US standards. However, in our view, the bright line tests are far preferable to the approach being recommended by the CSA. They establish minimum requirements for independence and a commonly understood standard for independence. Moreover, the collegiality established by many boards makes it difficult in some cases to conclude that a particular director is not independent in the absence of specific requirements.

7. Is it sufficiently clear that the phrase "reasonably perceived" applies a reasonable person standard?

There is great benefit in using language that is already accepted as communicating a specific concept. Accordingly, if the CSA is seeking to establish a reasonable person standard, we would suggest the following language:

> does not have, or has not had, any relationship with the issuer, or an executive officer of the issuer, which could, in the view of the issuer's board of directors having regard to all relevant circumstances, *be perceived by a reasonably prudent person* to interfere with the exercise of his or her independent judgment.

8. Is the guidance in the Proposed Audit Committee Policy sufficient to assist the board in making appropriate determinations of independence?

It would be helpful to make the point in the opening language that the issue is independence from management. It would also be helpful to explain the importance of the integrity of an issuer's financial reporting and the important role that an independent audit committee plays in that process. This context will be helpful to directors in assessing difficult independence issues.

9. The proposed definition provides that independence is independence from the issuer and its management, and not from a control person or significant shareholder. Given this definition:

(a) should a relationship with a control person or significant shareholder be specified in section 3.1 of the Proposed Audit Committee Policy as a relationship that could affect independence?

(b) *should such a relationship be solely addressed through Principle 6 – Recognize and manage conflicts of interest* as *proposed?*

(c) *is it appropriate to include as an example of a corporate governance practice that an appropriate number of independent directors on a board of directors and audit committee be unrelated to a control person or significant shareholder?*

Where there is a control person or significant shareholder, issues of director independence arise when the control person or significant shareholder is involved in management. The current and proposed definitions of independence address this issue. It is important not to create the impression in any way that shareholding alone comprises independence.

When the TSX Guidelines were in place, they included the following provision:

> If the corporation has a significant shareholder, in addition to a majority of unrelated directors, the board should include a number of directors who do not have interests in or relationships with either the corporation or the significant shareholder and which fairly reflects the investment in the corporation by shareholders other than the significant shareholder. A significant shareholder is a shareholder with the ability to exercise a majority of the votes for the election of the board of directors.

This recommendation was helpful in encouraging that a diversity of views are present in the boardroom. The CSA should include this in the guidance it provides.

10. Does the required disclosure on director independence provide useful and appropriate information to investors?

The required disclosure on director independence provides useful and appropriate information to investors with respect to the directors currently in office. The disclosure should be extended as appropriate to individuals who are being proposed for election to the board for the first time so that shareholders will have a complete picture of the skills and competencies of the members of the board that will remain relevant following the annual meeting. In many cases, decisions have been made about committee composition following the annual meeting. If this is the case, that disclosure should be included (again, because the disclosure otherwise becomes stale at the annual meeting).

As noted elsewhere, however, we are concerned that the elimination of benchmarks makes the disclosure much less effective than is currently the case under the comply or disclose regime.

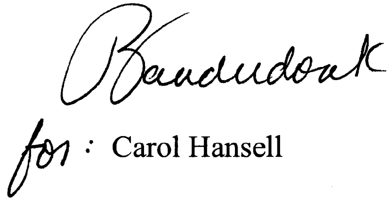
11. Do you think our proposal regarding the effective date adequately addresses the needs of both venture and non-venture issuers?

Normally, six months' notice of the changes would be sufficient. However, in the present time, issuers are dealing with very difficult economic conditions. As the economy starts to recover, there will be continuing challenges that will demand the full attention of both management and the board. In addition, issuers are dealing with the conversion to IFRS, which also absorbs a great deal of corporate resources. If the CSA proceeds with its proposed amendments, they

should wait for at least two years and reassess at that time whether issuers are in a position to deal with changes.

We hope these comments are helpful. We are available to discuss any aspect of our comments with you in greater detail.

Sincerely



Carol Hansell

CH/plv

APPENDIX A

Discussion Paper
on
Proposed Revisions
to
CSA Approach to Governance Regulation

Carol Hansell[1]
March 27, 2009

The Canadian Securities Administrators ("CSA") are proposing extensive revisions to their national policy on corporate governance (National Policy 58-201) and the related disclosure requirements (National Instrument 58-101). Those revisions will also revise and replace the current requirements relating to audit committees (currently set out in National Instrument 52-110).

The CSA's purpose in proposing these amendments is to enhance the standard of governance and confidence in the Canadian capital markets.[2] This discussion paper raises questions about whether the proposed amendments will meet that objective. It has been prepared to facilitate discussion in the director community and to encourage directors to provide comments to the CSA, either individually or through the Institute of Corporate Directors.[3] The period for response to CSA's Request for Comment ends on April 20, 2009.

Part 1 discusses the forces that have shaped corporate governance practices in Canada today and who influences developments in governance practices now. This will provide a context in which to discuss, in Part 2, whether the amendments being proposed by the CSA are the best approach to achieving their stated objectives.

In this paper:

- "Current CSA Provisions" means the Current Policy, Current Disclosure Requirements and Current Audit Committee Requirements
- "Current Policy" refers to National Policy 58-201
- "Current Disclosure Requirements" refers to National Instrument 58-101
- "Current Audit Committee Requirement" refers to National Instrument 52-110
- "Proposed Policy" refers to amendments being proposed in the Request for Comment
- "Proposed Audit Committee Requirement" refers to the proposed amendments to the Current Audit Committee Requirement as set out in the Request for Comment

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1 The author is a senior partner with Davies Ward Phillips & Vineberg LLP in Toronto and is the Chair of the Corporate Governance Committee of the American Bar Association (Business Law Section).

2 Request for Comment – Section 2.

3 Comments to the CSA can be provided as set out on the following website: http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part5/rule_20081219_58-201_rfc.pdf

- "Request for Comment" refers to Request for Comment – Proposed Repeal and Replacement of NP 58-201 *Corporate Governance Guidelines*, NI 58-101 *Disclosure of Corporate Governance Practices* and NI 52-110 *Audit Committees* and Companion Policy 52-110CP *Audit Committees*

Part I – Development of Governance Standards in Canada

1. Background

(a) Lead up - the early 1990s

Until the 1990s, the elements of governance for Canadian public companies were found almost exclusively in the corporate law. The basic framework in most Canadian jurisdictions was similar to the framework in the *Canada Business Corporations Act* ("CBCA") which came into force in 1975. There were few meaningful changes in the fundamentals of the governance regime as set out in the business corporations legislation for many years. In recent years, this has changed as investors have demanded fewer restrictions in the exercise of their rights and directors have searched for more clarity in their responsibilities and more protection against liability.

Securities regulatory authorities played a very selective role in the development of governance practices in Canada until the wave of global governance reform following Enron. However, the role they have played has been a meaningful one. The governance framework for dealing with related party and other special transactions in what is now Multilateral Instrument 61-101 has been important in creating confidence in the fairness and transparency of the Canadian marketplace. Another example is the CSA guidance on audit committee effectiveness released in 1990. Although audit committee requirements were still lodged entirely in the corporate statutes, the CSA developed guidance on Canadian audit committees which addressed virtually every issue addressed in the New York Stock Exchange ("NYSE") audit committee requirements almost 10 years later.

(b) The Elements of Change

There have been two watershed events that resulted in significant change in Canadian governance practices. In the first case, change was led by the private sector. In the second, it was the result of regulatory intervention.

(i) 1990 - 2001

The first watershed event occurred in the late 1980s and early 1990s, when several corporate icons failed, including financial institution Royal Trust and real estate giant Bramalea. Concern with decision making in Canadian public companies led to a comprehensive review of Canadian corporate practices by the "Dey Committee", a private sector group sponsored by the Toronto Stock Exchange ("TSX").[4] The Dey Report recommended 14 guidelines which were adopted by

[4] The Dey Committee and its report were modelled on the Cadbury Committee (sponsored by the London Stock Exchange) and the report that resulted from its deliberations.

the TSX and became known as the "TSX Guidelines". The TSX also adopted the disclosure requirement recommended by the Dey Committee, which required issuers to disclose whether their practices aligned with the 14 guidelines and, where they did not, to explain why not (i.e. comply or explain).

During this period, the institutional investor emerged as an important force in Canadian governance. Claude Lamoureux of Ontario Teachers' Pension Plan Board ("Teachers") was a consistent and highly respected voice in this area and contributed significantly to the evolution of Canadian governance standards. Teachers and Canada's leading other institutional investors developed the first iteration of their proxy voting guidelines, setting out their views on a variety of governance practices. This accomplished two things. It provided advice to issuers about the views held by some of their largest shareholders on important governance issues. It also created a non-regulatory environment in which shareholders, rather than regulators, could begin to influence governance standards.

In the five years after the release of the Dey Report, governance practices in Canada changed markedly, as issuers made the changes necessary to align their practices with the TSX Guidelines. Whether this was because they believed that these practices were an improvement or because they did not want to disclose that they had not adopted all of the guidelines is not obvious, but in the result, the issue is moot. Canadian governance practices rose to meet the bar set in the Dey Report. In addition, a body of disclosure about Canadian governance practices began to develop. Issuers also became increasingly mindful of the views held by major institutional investors and began to adapt their practices to those standards as well.

Before very long, however, a concern developed that issuers and their boards were not developing their governance thinking beyond the 14 guidelines set out in the TSX Guidelines and that alignment with those practices had become largely a "check the box" exercise. This concern was articulated at a reunion meeting of the Dey Committee in 1999 sponsored by the Institute of Corporate Directors ("ICD") and the TSX. The meeting discussed the results of research commissioned by the two organizations on the current state of corporate governance among TSX-listed companies. The summary findings of the report read in part as follows:

> The research findings present a complex picture. On one hand, it is clear that most corporations take the TSE guidelines seriously. Many of the largest companies that account for the greatest proportion of Canadian equity investment are leaders in corporate governance. A number of the TSE guidelines are now broadly accepted business practices. On the other hand, important areas remain where general practice falls short of the guidelines' intent. We see real opportunities for the TSE and ICD to help foster sound practices.

The result was a second private sector committee – this one sponsored by the TSX, TSX Ventures and the Canadian Institute of Chartered Accountants ("CICA"). It was chaired by Guylaine Saucier, an experienced and widely respected director.[5] The resulting report was

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[5] The members of the Saucier Committee (and their associations as noted in the report) were: Guylaine Saucier (Chair), Ralph Barford (Chair, Valleydene Corporation Limited), Jalynn Bennett (President, Jalynn H. Bennett & Associates), Tullio Cedrashi (President and CEO, CN Investment Division), L. Yves Fortier (Chairman, Ogilvy Renault), Brian MacNeill (Chair, Petro Canada), Roger Martin (Dean, Joseph L. Rotman School of Management), Frank McKenna (McInnes Cooper), Tom O'Neill (CEO,

entitled "Beyond Compliance: Building a Governance Culture". It focussed on three key issues that, in the view of the committee, went beyond compliance and are fundamental to building a healthy governance culture. These issues were:

> 1. measures that can be taken to strengthen the capacity of the board to engage in a mature and constructive relationship with management – one that is grounded in a mutual understanding of respective roles and the ability of the board to act independently in fulfilling its responsibilities;
>
> 2. the critical role that the board must play in choosing the CEO of the company, in actively contributing to the company's strategic direction, approving a strategic plan and monitoring performance against agreed benchmarks; and
>
> 3. particular issues that independent directors must face in corporations that have significant shareholders.

The Saucier Report moved Canadian governance thinking forward once again. However, its recommendations were eclipsed by the Enron crisis, which broke several months prior to the release of the report.

(ii) 2001 to the present

The second watershed event was the global crisis of confidence in the capital markets that began with the demise of Enron in 2001 and continued with other large scale corporate collapses such as Worldcom, Tyco and Adelphia that followed. These events occurred little more than a year after the NYSE had adopted comprehensive requirements for audit committees of its listed companies. The US government responded to this crisis in confidence by adopting the *Sarbanes Oxley Act, 2002* ("SOX") which focussed primarily on governance practices affecting financial reporting. A short time later, the NYSE adopted listing requirements that spoke to governance issues beyond financial reporting, including compensation committees, nominating committees and codes of conduct.

The importance of the US marketplace to global capital markets led other jurisdictions to follow the new US approach to governance regulation. Canadian securities regulators were anxious to make clear to the world capital markets that governance regulation in Canada was no less rigorous than in the United States. Accordingly, the CSA adopted a number of the provisions of SOX. Canadian audit committees became subject to regulations that mirrored the SOX/NYSE approach, with a few adjustments to accommodate certain issues specific to the Canadian environment. The CSA also adopted CEO/CFO certification requirements that are substantially the same as those imposed in the US. When it came to SOX 404, Canadians waited to see what the US experience would be with the rigorous requirements of this provision. Ultimately, the CSA took a different path in respect of internal controls.

PricewaterhouseCoopers), John A. Roth (Former President & CEO, Nortel Networks Corporation), C. Alan Smith (President, Aeonian Capital Corporation), and David Sutcliffe (President & CEO, Sierra Wireless). Mr. Martin left the Committee in June 2001 due to other commitments and Mr. Cedrashi left the Committee in September 2001 upon being appointed a governor of the TSX.

(iii) CSA Becomes Responsible for Governance

During the post-Enron period, the CSA assumed the leadership for public company governance in Canada. and the governance framework set out in securities legislation began to take shape. Audit committee requirements previously found in the corporate statutes were introduced (in much enhanced form) into securities legislation across the country. Disclosure controls, internal controls and certification became familiar terminology as a result of other requirements, policies and guidance by securities regulators. It was at this time that the CSA adopted the Current Policy and the Current Disclosure Requirement, rendering the TSX Guidelines and related disclosure unnecessary. The reason advanced for this move was that the quality of governance disclosure needed to be improved and the TSX had little in the way of remedies available to it to deal with substandard disclosure. The CSA, on the other hand, could include corporate governance disclosure in their continuous disclosure reviews and use its regulatory authority to enforce better disclosure. The Current Policy was modelled on the TSX Guidelines, with the 14 guidelines drawn from the Dey Report becoming 18 guidelines in the Current Policy. The Current Disclosure Requirement was different in many ways from the TSX disclosure requirements, but together with the Current Policy preserved the "comply or explain" regime adopted by the TSX in 1995.

With this change, Canada began its move away from the approach still used in other jurisdictions in the development of governance practices today. In the US, the UK and Australia, for example, guidance with respect to governance practices is developed by private sector boards or committees. Most recently, in Australia, it was the Council of Corporate Governance that led the review of Australia's corporate governance principles maintained by the Australian Securities Exchange. The revised governance principles recommended by the Council were the result of consultation attracting over 100 submissions for comment. The resulting report describes the council as follows:

> The ASX Corporate Governance Council was formed in August 2002 and has been chaired by the Australian Securities Exchange (ASX) since its inception. The Council is a remarkably diverse body, bringing together 21 business, investment and shareholder groups. Its ongoing mission is to ensure that the principles-based framework it developed for corporate governance continues to be a practical guide for listed companies, their investors and the wider Australian community. The Council's diverse range of voices is one of its strengths. Its striving for consensus is consistent with maintaining balance in regulatory and reporting affairs.

In South Africa, the report referred to as "King III" that is currently out for comment was led by Professor Mervyn King and assisted by six researchers and 79 people on nine subcommittees responsible for particular areas of governance (boards and directors; audit committees; risk management; internal audit; integrated sustainability reporting; compliance with laws, regulations, rules and standards; managing stakeholder relationships; fundamental and affected transactions and business rescue). In the UK, the current review of the Combined Code is being led by the Financial Review Council, the UK's independent regulator responsible for promoting confidence in corporate governance and reporting. The Financial Review Council is comprised on industry participants who bring experience and a diversity of perspectives to their deliberations.

With the CSA assuming responsibility for establishing and enforcing governance disclosure requirements, Canada also became the only jurisdiction in which these practices are dealt with directly by securities regulators, rather than by the listing authorities.

2. Private Sector Leadership in Canada

(a) The Role of the Private Sector in the Development of Canadian Governance Practices

(i) Why Was the Dey Report Successful?

When the Dey Report was written, it was the first guidance of its kind in Canada. The fact that it was so widely accepted and remains the foundation piece for governance practices for Canada is due in large part to the composition of the Committee and the process that Committee followed. Peter Dey, the Committee Chair, was a former OSC Chair and a highly respected corporate lawyer and investment banker. The Committee was composed of other individuals who had played a role in the governance process.[6] It included the CEO's of three major Canadian public companies and two of Canada's largest institutional investors as well as senior members of Canada's academic, legal, accounting and investment banking communities. Most of the Committee members had served on boards of public companies in Canada. The TSX acted as the Committee's sponsor, but did not participate in formulating the Guidelines or in writing the Report.

The process used by the Dey Committee was highly consultative. It accepted written submissions and held public hearings. It issued a draft report for comment and responded to concerns addressed by reflecting significant revisions in its final report.

(b) Other Private Sector Reports

The Dey Report is not the only private sector initiative that has had a significant impact on governance practices in Canada. The TSX has been an important sponsoring organization for many of these initiatives (in many cases in cooperation with other sponsoring organizations). It played this role not only for the Dey Committee, the Five Years to the Dey reunion meeting and the Saucier Committee, but also for the Allen Committee (which led to civil liability for secondary market disclosure) and the Securities Industry Committee on Analyst Standards and the Mining Standards Task Force. The accounting professions also played an important role.

[6] The members of the Dey Committee (and their affiliations as set out in the report) were as follows: Peter Dey, Chair (President & Managing Director, Morgan Stanley Canada Limited), Robert Brown (Chairman & Senior Partner, Price Waterhouse), Purdy Crawford (Chairman of the Board, Imasco Limited), Ron Daniels (Dean, Faculty of Law, University of Toronto), Jean-Claude Delorme (Advisor to the Chairman, Caisse de depôt et placement du Québec), Wendy K. Dobson (Professor, University of Toronto), K. Michael Edwards (President & Chief Operating Officer, Richardson Greenshields of Canada Ltd.), Thomas E. Kierans (President & Chief Executive Officer, C.D. Howe Institute), Claude R. Lamoureux (Chief Executive Officer & President, Ontario Teachers' Pension Plan Board), David S.R. Leighton (Professor Emeritus, School of Business Administration, University of Western Ontario), J. William E. Mingo (Partner, Stewart McKelvey Stirling Scales), J. Edward Newall (Chief Executive Officer and Chairman of the Board, NOVA Corporation), and Michael E. J. Phelps (Chairman and Chief Executive Officer, Westcoast Energy Inc.).

CICA sponsored the Committee that produced the Macdonald Report, an important work in understanding the role of the auditor, the expectation gap and the importance of strengthening the audit committee. Together with the TSX and CDNX (now TSX Venture Exchange), it sponsored the Saucier Report. It is also responsible for the highly respected "20 Questions" series of publications for corporate directors.

3. Who Is Driving the Governance Agenda Today?

Prior to the economic challenges of the late 1980s, the governance field was occupied by legislators and regulators. As described above, private sector studies sponsored by organizations such as the TSX and the CICA grew to be an important influence, as did shareholders themselves, as institutional investors developed their proxy voting guidelines.

Today, institutional investors are one of the most important influencers of Canadian governance practices. Under the leadership of Claude Lamoureux and Stephen Jarislowsky, the Canadian Coalition for Good Governance ("CCGG") was established. Today, the CCGG (Chair, David Denison; Managing Director, Stephen Griggs) brings together the thoughts and influence of 46 member pension funds, mutual funds and third party money managers - which are collectively responsible for the management of approximately $1.4 trillion of assets. Among other initiatives, the CCGG has issued Guidelines and Position Papers on corporate governance practices, but also on executive compensation, majority voting and break fees.

The Globe and Mail has also become an important factor, as a result of Board Games, developed by Janet McFarland and Elizabeth Church. Board Games is a ranking system published in the Globe and Mail's Report on Business. Guidelines against which organizations are ranked are developed from the recommendations of major institutional investors, academics and industry associations, and are reviewed each year. In 2008, the Globe published its 7th Annual Board Games.

Over the last 15 years, governance has also become a recognized area of study. There are many thoughtful books and articles that deal with appropriate governance practices. Some have been written by experienced directors, relying on many years in boardrooms. Others have been written by academics, based on empirical data.

Finally, organizations dedicated to governance have grown enormously. The CCGG is referred to above. The Institute of Corporate Directors in Canada and the National Association of Corporate Directors in the United States are the organizations best known to Canadians, but there are similar organizations in other parts of the world. These organizations provide education, produce research and offer a forum for discussion about governance practices in a variety of circumstances.

There is ample evidence that the private sector agenda has a strong influence on governance practices. The separation of the positions of CEO and Chair, the elimination of stock options for directors and majority voting have all been a result of investor-led initiatives.

Part II – Proposed Amendments

This part describes the Current Policy and the changes that are being proposed. Against the background set out in Part I, it then raises questions about whether the Proposed Amendments should be pursued.

4. Overview of the Background and Elements of the Amendments

(a) Overview of the Amendments

The Current Policy sets out 18 guidelines. The Current Disclosure Requirement requires issuers to disclose certain facts about their governance practices and then to describe whether they follow certain practices, and if not, what they do to achieve the same objective.

Under the Proposed Policy, the CSA would no longer recommend any particular practices. It would instead set out nine principles, each of which would be accompanied by a commentary that explains the principle, followed by "examples of practices". Many of the concepts that now form part of the recommended practices in the Current Policy would survive as examples of practices that are among those that the CSA believes could help an issuer achieve the stated principle if adopted.

(b) Why Is the CSA Proposing These Amendments?

From the time it published the Current Policy in 2005, the CSA noted that it intended to review both the policy and the related disclosure requirements periodically to ensure that the guidelines and disclosure requirements continue to be appropriate for issuers in the Canadian marketplace. Two years later, in September 2007, the CSA issued Staff Notice 58-304 announcing its plans to undertake a broad review of the Current Policy and the Current Disclosure Requirement and to publish its findings and any proposed amendments for comment in 2008. The result is the proposed amendments, which are the subject of this paper.

Why has the CSA proposed a complete change in its approach to governance? In its Request for Comment, it offered two reasons.

First, it noted that both issuers and investors have had concerns about the current governance regime. It does not, however, explain what those concerns were or who expressed them. Staff Notice 58-304 refers to certain research and analysis conducted by the CSA:

> ...we have conducted extensive research and analysis, including a survey of institutional investors and rating agencies, an analysis of proxy circulars filed by Canadian controlled companies, an analysis of requirements or guidelines regarding independence and composition of boards and committees found in other jurisdictions, and a review of recent academic literature on governance matters. This research and analysis will be considered in the context of the broader review contemplated by this Notice.

The Staff Notice does not explain the scope of the research the CSA conducted, the nature of the questions posed in its survey or who (other than institutional investors and rating agencies) might

have been solicited for comment. The Request for Comment states that in developing its proposals, the CSA did not rely on any unpublished study, report or other written materials.

Second, in its Request for Comments, the CSA noted that corporate governance has evolved both domestically and internationally and that it considered the corporate governance regimes in other jurisdictions (including Australia, the UK and the US). While it is clear from the Proposed Policy that the CSA drew heavily on the practices in other jurisdictions, it does not offer any explanation for the choices it made or those it rejected. It notes that while elements of its proposals are similar to regimes in other jurisdictions: "...we do not believe that it would be helpful to adopt those regimes in their entirety given the unique characteristics of the Canadian market". It does not elaborate on the characteristics of the Canadian market which it considers to be unique or which practices from other jurisdictions it felt had application in Canada.

It is difficult to comment on the approach the CSA is proposing without understanding the issues in Canada or the changes in international governance to which its proposals are responding. Those with a stake in the CSA's approach to governance would benefit from some insight into the rationale for the CSA's proposals.

Finally, the Request for Comment also notes that current corporate governance disclosure "[is] often inadequate and does not provide clear or complete accounts of governance practices".[7] This was precisely the concern that the CSA was trying to address when corporate governance disclosure was the responsibility of the TSX. Whether any change is made, or whether the current provisions remain, the quality of disclosure would surely improve by continuous disclosure reviews that are understood by issuers to be rigorous and which will result in changes to disclosure being required by the regulators.[8]

5. Rejecting the Comply or Explain Regime

(a) Issues Relating to Compliance with the Current Policy

(i) Would the Principles-Based Approach Achieve the Stated Objective?

The CSA is proposing a move to a principles-based approach to governance, largely in order to avoid giving issuers the impression that the CSA is trying to dictate governance practices. The objective is to encourage issuers to develop governance practices that are most appropriate for their specific practices.

Is it true that the current comply or explain approach results in issuers simply adopting the recommended practices in the Current Policy? This certainly seems to be the case. Is this because they believe there will be regulatory consequences from not adopting those practices? Given how clear the Current Policy itself is that the CSA does not require compliance (and therefore does take action against issuers who do not comply) this seems unlikely. In any event, the approach being proposed by the CSA sets out example practices that the CSA believes may

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7 Request for Comment – Section 6.

8 The TSX has continued to review the governance disclosure by its listed issuers and to discuss deficiencies with those issuers.

support the objectives of each of the nine principles. It is not clear why the CSA believes that issuers will not look at these examples as *de facto* recommendations and therefore *de facto* requirements, just as they do with the Current Policy. Similarly, even if an issuer accepts that it will not be sanctioned for lack of compliance, but is concerned that any lack of conformity with a regulatory view will cast it in a negative light with the regulators, will that issuer really feel less compelled to adopt the example practices in the Proposed Policy than the recommended practices in the Current Policy?

If issuers are not concerned about regulatory action if they do not adopt the practices in the Current Policy, why do they adopt them? Many issuers likely believe that the recommended practices are appropriate. There is presumably no need to eliminate the recommended practices for these issuers. Other issuers may be concerned that their own practices will not compare favourably with the recommended practices (and may result in investors assigning a "governance discount" to their stock). This, of course, is precisely the point of the Current Disclosure Requirement – to give the reader a basis on which to evaluate the issuer's practices (and to provide an incentive for issuers to move to a generally accepted standard where it is more appropriate). It is presumably not in the interest of investors to eliminate the recommended practices for these issuers. Finally, some issuers may just not believe that governance is very important but that compliance is the path of least resistance. Again, the benefit of the recommended practices is that they provide these issuers with a default position that has been generally accepted by the Canadian marketplace.

Does the current approach prevent issuers from adopting governance practices that go beyond those set out in the Current Policy? The impact of institutional investors on Canadian governance practices, particularly through the CCGG, suggests that this is not the case. Many issuers adopt the governance practices recommended by institutional shareholders without any more question than they have in adopting the practices recommended by the CSA. If the concern is that issuers don't go beyond the body of practices recommended by regulators, shareholders, the legal and accounting professions and by governance organizations, that may well be true. Even if one concluded that this were desirable however, would the amendments being proposed by the CSA inspire issuers to think more independently about their practices than they have been prepared to do under the current regime, with all of the thought leadership that has been developed by what has now become a governance industry?

If it is the case that the current comply or explain regime is really the barrier to issuers being more independent in the development of their governance practices, the CSA could assist issuers in this regard simply by providing positive reinforcement for issuers who disclose more customized practices. A staff notice or other communication citing examples of issuers who have disclosed that they do not follow a certain practice in the Current Policy and have described effectively the practice that they have adopted would give many other issuers the confidence to do the same. This would be much less costly to issuers than overhauling the entire governance policy and disclosure regime.

(ii) What Would We Lose?

What would we lose if there ceased to be a set of recommended governance practices?

If the principles-based approach were successful, we would lose the generally accepted baseline of governance practices that we have today. The practices in the Current Policy have long been accepted as generally appropriate practice (subject to concerns expressed with respect to some practices on behalf of controlled companies and smaller issuers). In fact, those that originate with the Dey Report (as most did) were not radical even at the time that report was released. Where is the harm in the CSA encouraging issuers to adopt at least the broadly accepted baseline practices being recommended in the Current Policy? While these practices represent only a very small part of an issuer's overall governance practices, they establish an important foundation of common and generally accepted practices.

In addition, we would lose the ability to demonstrate a common governance standard with US issuers. The Current Policy aligns in every material respect with the requirements imposed by US stock exchanges for their listed companies. This allows Canadians to make the simple point that, at least to that extent, our governance practices are no less rigorous than those imposed on US domestic issuers. This allows us to deliver a clear message to those who understand the US governance environment and who will not take the time required to understand an entirely separate governance regime in place in a very small market. There was a strong sense at the time that the Current Policy and other governance reforms were adopted that there was merit in this comparability. It would be helpful to know whether the CSA sees any value in this comparability now and, if not, why not.

(b) Issues Relating to the Disclosure Requirement

Under the Current Disclosure Requirement, issuers must disclose certain elements of their governance practices and, in some cases, disclose whether those practices are consistent with those recommended under the Current Policy. Under the Proposed Disclosure Requirements, issuers would still be required to disclose certain facts about the issuer's governance practices. As well, the issuer would be required to describe certain aspects of its governance practices. There is no requirement to refer back to the Proposed Policy as a point of comparison with the issuer's practices. However, the CSA believes that broader disclosure with respect to practices, broader requirements to disclose how practices operate to achieve an articulated objective and the CSA's continuous disclosure review will result in more complete disclosure about an issuer's governance practices. In many respects, this will certainly be the case. For example, the detail required with respect to director independence would provide investors with much more information. The following is the current disclosure requirement with respect to director independence:

> (a) Disclose the identity of directors who are independent.
>
> (b) Disclose the identity of directors who are not independent, and describe the basis for that determination.
>
> (c) Disclose whether or not a majority of directors are independent. If a majority of directors are not independent, describe what the board of directors (the board)

> does to facilitate its exercise of independent judgement in carrying out its responsibilities.

In contrast, the following would be required under the Proposed Disclosure Requirements. The reader would have disclosure about what the board considered in determining that a particular director is independent. In addition, a reader would have disclosure of all of the business relationships between the board and the director.

> (d) State the names of the directors considered by the board to be independent, with the following information for each of those directors, if any:
>
> > (i) a description of any relationship with the issuer or any of its executive officers that the board considered in determining the director's independence; and
> >
> > (ii) if the director has a relationship referred to in sub-paragraph (i), a discussion of why the board considers the director to be independent.
>
> (e) State the names of the directors considered by the board to be not independent and the basis for that determination.
>
> (f) If a director has a business or other relationship with another director on the issuer's board, other than common membership on the issuer's board, provide information about that relationship.

However, several other points should be taken into account in considering whether the Proposed Disclosure Requirements will improve governance disclosure.

First, whether this change results in more expansive disclosure will depend largely on the perspective the issuer brings to the disclosure and the time the CSA devotes to coaching issuers towards disclosure that is more expansive, even if it is not specifically required by the instrument. Coaching is, of course, not enough – the CSA must be prepared to enforce compliance with its disclosure requirements. Compliance and enforcement are, of course, also issues today.

Second, issuers who believe that governance disclosure has value to its stakeholders will provide appropriate disclosure. However, not all issuers assign a high priority to governance or governance disclosure and there is too little in the Proposed Disclosure Requirements that requires issuers to explain their practices. In many cases, compliance can be achieved by simply stating that it has no formal practices without any explanation of reasons for this approach. Moreover, in the absence of the benchmarks currently provided in the form of the recommended practices, a reader will not know whether the issuer's practices are in line with current standards of governance. To be required to say "we don't do A, but we do B instead" and to provide an explanation for the approach allows the reader some basis on which to evaluate the governance practices and is instructive for investors who are trying to determine the corporate governance practices that should be considered acceptable. Whether disclosing practices against the objective that they are intended to further will be as effective is a question for discussion.

Third, if issuers are not required to discuss their governance practices against a common benchmark, there will be very little to compare the disclosure of one issuer to another. Unless the

reader is quite sophisticated in the range of governance practices and what is generally thought to be appropriate practice, he or she will be evaluating the issuer's governance practices in a vacuum.

Finally, the Proposed Disclosure Requirements would take Canada in a very different direction from other jurisdictions. The NYSE's listing requirements are rules-based – the issuer must adopt certain governance practices. Both the UK and Australia have to comply or explain models. Although the recently revised Australian model sets out certain principles (as the Proposed Policy could), it also requires issuers to explain their own governance practices against practices recommended in a corporate governance code that recommends specific practices.

6. Other Issues

The Proposed Policy would no longer recommend an independent compensation committee. It would also not recommend an independent nominating committee, orientation or education programs for directors or even that a majority of directors be independent of management. Each of these now generally accepted practices (at least for TSX listed issuers) would instead be possible practices that an issuer could adopt in order to achieve the objectives of each of the articulated principles. Two other substantive changes should also be noted – the elimination of the requirement to file a Code of Conduct and the changes in the definition of independence.

(a) Code of Conduct Would No Longer Be Required

Under the Proposed Amendments, the CSA would no longer require an issuer to file a copy of its code of conduct and ethics or an amendment to the code through SEDAR. An issuer would be required only to provide a summary of any standards of ethical and responsible behaviour and decision-making or code adopted by the issuer and describe how to obtain a copy of its code, if any.

While many (although not all) issuers have long recognized the value of a code of conduct, the development of the code of conduct and all of the subsequent effort involved was not a priority for many issuers until the NYSE and then the CSA required that codes be developed and filed. It is, of course, not simply the drafting of the code that is important. The process of educating employees, monitoring compliance and remediating deficiencies is also important. While this can be done without formal codes and policies, it is much less likely to be done. The existence of a code, of course, is also an important element in assessing corporate culpability should illegal activity occur (although the existence of a code with which the issuer has not complied can be quite harmful). While a case could be made that this is simply too much process for certain very small issuers, it is not clear why it will be an advantage to the Canadian capital markets to eliminate this requirement altogether.

(b) Definition of Independent

Currently, the definition of independence is found in the Current Audit Committee Instrument and includes two tests. One was taken from the NYSE definition of independence. It includes both a requirement that the board conclude that the director is independent and a bright line test that precludes certain people from being considered independent. This includes close family members, consultants who earn more than a specified amount from the issuer, individuals who

have worked in certain capacities with the issuer's auditor and individuals who work for an organization whose compensation committee includes one of the issuer's executive officers.

The second test provides that a member of an audit committee may not earn any fees whatsoever from the issuer. The rationale for this was at least in part that it is typically management that retains consultants and that the importance of the audit committee to the financial reporting system demands absolute independence from management. If a member of the audit committee is concerned to any extent with his or her relationship with management (for example because he or she wishes to retain the consulting arrangement), independence may be compromised.

The Proposed Policy would eliminate the second test altogether. With regard to the first test, two changes would be made. Most significantly, most of the bright line tests would be eliminated. If a board concludes that the fact of a director being the CEO's cousin could not reasonably be perceived to interfere with the exercise of that member's independent judgment, then the board may conclude that that director is independent. (Although it should be noted that where a board makes decisions about whether a director should be considered independent that are not perceived by stakeholders as being defensible, the reputation of the board could well be compromised. This may ultimately be more effective than bright line tests.) As a result, that director could sit on a compensation committee or on an audit committee that the issuer may then refer to as being independent under all applicable Canadian securities laws. It should be noted that this approach is quite similar to the approach in the TSX Guidelines, which left the determination of which directors were independent (referred to in the TSX Guidelines as "unrelated") to the directors. The lack of rigor in many of these determinations was in part what led to the adoption of the bright line tests.

The other change is that the test for the board determination is whether a relationship "could, in the view of the issuer's board of directors having regard to all relevant circumstances, be reasonably perceived to interfere with the exercise of his or her independent judgment". This replaces the current test: "could, in the view of the issuer's board of directors, reasonably interfere with the exercise of a member's independent judgment". The CSA has changed "expected" to "perceived" because it believes that the concept of perception is broader than that of expectation and is more appropriate in view of the removal of the "bright line" tests.

It is worth considering whether the independence question matters as much as it did in the past. There is little debate about the importance of independence to the audit committee and the compensation committee. However, there are many who believe that the primacy of independence has caused many boards to operate with directors who are entirely independent but who lack the skills, attributes and industry knowledge that would be most valuable to the issuer's business.

7. What the Policy Says

It is beyond the scope of this paper to analyze each of the nine principles in the Proposed Policy. The section raises questions about the two principles which many would consider key in the current environment – risk and compensation – to illustrate some of the issues that need to be considered in detail throughout the Proposed Policy and Proposed Disclosure Requirements.

In considering any of the principles and their associated commentary and practices, some consideration should be given to whether the CSA is the appropriate body to be developing this type of guidance for Canadian companies. The Dey Report was informed by open public consultation under the guidance of very seasoned members of the Canadian governance community. Approaches in other jurisdictions vary, but, as noted above, the recent revisions to the governance code in Australia was informed by the work of a very diverse private sector committee. The members of the Corporate Governance Committee that oversees the Combined Code in the UK are experienced industry players and stakeholders. Staff of the CSA are very familiar with governance issues through the disclosure they review and the issues they discuss with issuers and their advisers. But are they well suited to distil the elements of the current governance environment into principles that should guide Canadian public companies? Those who hold positions of Commissioner (or comparable positions) of a securities regulatory authority are often experienced directors, but do they have the breadth of experience and the opportunity for input at the right time that would make an effective impact on the development of regulatory guidance on governance? Finally, the CSA offers national balance – but are regional differences significant enough to be influencing the development of governance policy? Finally, the CSA does engage in a consultation process – through the comment period to which this paper is responding. But is this an appropriate point of involvement for the governance experts and practitioners who know better than anyone what constitutes effective governance?

In addition, it must be remembered that what regulators say – even if it is simply guidance – is taken seriously by those they regulate. That was, after all, the concern the CSA expressed about the Current Policy and Current Disclosure Requirement – that because the regulators are recommending particular practices, issuers will implement those practices, rather than turning their minds to practices that may be more appropriate for them. For the same reason, it is important that CSA policies, instruments and staff notices articulate requirements clearly and not create inadvertently conflict or contradict legal principles set out in the corporate statutes or in judicial decisions.

(a) Risk

Principle 7 deals with risk and is one of three areas in which the CSA states that the Proposed Policy broadens its approach beyond the issues specifically dealt with in the Current Policy (the other two being Principle 6 (Recognize and manage conflicts of interest) and Principle 9 (Engage effectively with shareholders)). The principle provides: "An issuer should establish a sound framework of risk oversight and management." The text of the Commentary and Examples of Practices are set out in Appendix 2. The disclosure requirement is: "Disclose a summary of any policies on risk oversight and management adopted by the issuer."

Several more specific points about the treatment of risk in the amendments being proposed by the CSA are set out below. The main point, however, is that the amendments will do little to move forward this very challenging area of governance or help investors understand how risk is dealt with in Canadian public companies. This topic, in particular, requires input from seasoned members of management and boards.

(i) Approaches to Risk Management

Risk management is one of the most challenging areas for issuers and particularly for their boards. Both the Dey Report and Saucier Report identified risk management as an important component of the board's oversight function. The Dey Report, TSX Guidelines and the Current Policy all recommend that the board specifically assume responsibility for certain matters, including "the identification of the principal risks of the corporation's business and ensuring the implementation of appropriate systems to manage these risks". The Saucier Report recommended that the TSX Guidelines be amended to make it clear that the board's responsibility goes beyond the adoption of a strategic planning process:

> The board should be responsible for contributing to the development of strategic direction and approving a strategic plan that takes into account an identification of business opportunities and business risks. It should oversee and monitor management's systems for managing business risk. And it should regularly review, with management, the strategic environment, the emergence of new opportunities and risks, and the implications for the strategic direction of the company.

Generic descriptions of risk management processes tend to be very unsatisfying and not terribly helpful to people who do not already have command of the issue. For these reasons, the Commentary associated with Principle 7 may be of little assistance. It is worth considering whether the CSA has the expertise necessary to be providing the guidance set out in this Commentary. It says, for example, that risk management as a separate activity is not as effective as risk management "embedded into the issuer's practices and business processes". It does not explain what is involved in embedding risk management into practices and business processes or why the CSA considers this to be a more effective approach. It would be very helpful if the CSA referred the reader to the authority on which statements such as this are based.

Principle 7 is similar to the principle in Australia's Corporate Governance Principles and Recommendations and so it is helpful to compare the guidance provided there to support this principle. (As noted elsewhere in this paper, this document is the result of the study and recommendations of the ASX Corporate Governance Council, a broadly based Council which includes representatives from the legal, accounting, investor relations and shareholder communities.) The recommendations in that document are much more specific and actionable. It also makes specific reference to the internal control function (a critical feature of risk management) and the CEO/CFO certification requirement.

> Principle 7 – Recognise and manage risk
>
> Companies should establish a sound system of risk oversight and management and internal control.
>
> Recommendation 7.1: Companies should establish policies for the oversight and management of material business risks and disclose a summary of those policies.
> • Recommendation 7.2: The board should require management to design and implement the risk management and internal control system to manage the company's material business risks and report to it on whether those risks are being managed effectively. The board should disclose that management has

> reported to it as to the effectiveness of the company's management of its material business risks.
>
> • Recommendation 7.3: The board should disclose whether it has received assurance from the chief executive officer (or equivalent) and the chief financial officer (or equivalent) that the declaration provided in accordance with section 295A of the Corporations Act is founded on a sound system of risk management and internal control and that the system is operating effectively in all material respects in relation to financial reporting risks.
>
> • Recommendation 7.4: Companies should provide the information indicated in the Guide to reporting on Principle 7.

(ii) Role of the Board

The Commentary refers back to Principle 1 for the statement that the board is usually responsible for identifying the principal risks of the issuer's business and ensuring that the appropriate systems are in place to manage these risks. This repeats the same problematic language that originated with the Dey Report. The board is not, of course, equipped to identify the issuer's risk – as in virtually every other area, the role of the board is one of oversight. It is management that identifies the risks facing the issuer – the board oversees the process by which management has done so and questions its conclusions.

(iii) Disclosure

The disclosure requirement associated with risk is unlikely to provide disclosure that will be helpful to the reader. It reads as follows:

> Disclose a summary of any policies on risk oversight and management adopted by the issuer.

This requirement does not relate back to the principle (if it did, the disclosure requirement would be for the issuer to describe its framework for risk oversight and management.)

(b) Compensation

Compensation decisions are the other key issue of concern in the current environment. Principle 8 states that: "An issuer should ensure that compensation policies align with the best interests of the issuer".

(i) Role of the Board

An important feature of governance reform both in the early 1990s and then again post-Enron was ensuring that the board of directors accepted direct responsibility for the stewardship of the organization and specifically acknowledged its role in certain key areas – including executive compensation. Principle 8 is not consistent in lodging responsibility for executive compensation with the board - instead it characterizes compensation as being the responsibility of the "issuer". The Commentary explaining this principle refers to the role of the board in saying that responsibility for compensation policies and practices rests with the full board, but only provided

that the board should "....be satisfied that appropriate compensation policies and practices are in place for executive officers and directors". This is in contrast to the Current Policy which recommends that the board appoint an independent compensation committee and sets out specific responsibilities (including responsibility for approving – or recommending to the board – CEO compensation and recommending to the board with respect to non-CEO officer and director compensation, incentive-compensation plans and equity-based plans). The examples of practices that could achieve the stated objective refer to the compensation committee as one possible approach.

(ii) Fiduciary Duty

The corporate statutes and common law are clear about their fiduciary duty to the corporation – in discharging their responsibilities, they are required to act honestly and in good faith with a view to the best interests of the corporation. Although the CSA would clearly not intend to compromise this duty in any way, the language of Principle 8 gives the impression that compensation practices must be used to encourage management to act in accordance with that duty. The Commentary states that: "[C]ompensation should be set and structured to attract and retain executive officers and directors and motivate them to act in the best interests of the issuer."

(iii) Short vs Long-Term Objectives

The Commentary also states that an issuer's compensation philosophy should include a balanced pursuit of the issuer's short-term and long-term objectives. Whether or not this is an appropriate objective, it is not clear that the CSA should be providing this guidance. The corporate statutes and the courts have declined to prescribe for boards whether their focus should be on the short-term or long-term interests of the corporation or whether they should be seeking a balance between the two. It is reasonable to ask whether the CSA should be making this type of statement.

8. Other Issues

There are two core issues that have plagued the Canadian governance debate since the beginning. The first is the appropriate governance principles for widely held companies vs companies with a controlling shareholder. The second is the extent to which smaller issuers should be exempt from governance recommendations and disclosure requirements or subject to an entirely separate regime.

(a) Controlled Companies

In Part I of the Current Policy, the CSA referred to the concerns that some parties had about how that policy and related disclosure requirements affected controlled companies:

> We do, however, understand that some parties have concerns about how this Policy and National Instrument 58-101 *Disclosure of Corporate Governance Practices* affects controlled companies. Accordingly, we intend, over the next year, to carefully consider these concerns in the context of a study to examine the governance of controlled companies. We will consult market participants in conducting the study. After completing the study, we will consider whether to

> change how this Policy and National Instrument 58-101 treat controlled companies.

The control block shareholder is the factor in the Canadian governance environment that the CSA has consistently declined to address. The Dey Report (and, as a result, the TSX Guidelines) addressed the issue of the "significant shareholder", recommending that the composition of the board reflect the truly public float. The Saucier Report recommended that the definition of significant shareholder be revised to extend to *de facto* control blocks that recommend less than a majority of the voting shares. Rather than addressing the issue of how governance practices may legitimately differ where an issuer has a controlling shareholder, investors will need to glean this from their own review of the disclosure of these issues.

The amendment being proposed by the CSA deals with issues relating to controlled companies in three ways. First, a control person or significant shareholder would not be disqualified from being independent, but the CSA encourages boards to consider the involvement of the control person or significant shareholder with management. Depending on the nature and degree of this involvement, the CSA notes that this relationship may be reasonably perceived to interfere with the exercise of independent judgment.

Second, Principle 6 deals with conflicts of interest and reads as follows: "An issuer should establish a sound system of oversight and management of actual and potential conflicts of interest." The commentary explaining this principle describes a number of situations in which conflict of interest may arise. One is when "...there is a significant divergence of interests among shareholders or their interests are not completely aligned". Another is when "...a contract, arrangement or transaction is entered into between an issuer and a control person or significant shareholder".

Finally, among the practices suggested in order to support Principle 2 – Structure the board to add value is "having an appropriate number of independent directors who are unrelated to any control person or significant shareholder".

(b) Size of Issuer

The Proposed Policy and Proposed Disclosure Requirement would be applicable to all issuers (with certain exceptions that are unrelated to size). This will surely not be welcomed by small issuers who will be subject to much more extensive disclosure requirements under the Proposed Disclosure Policy. As noted elsewhere in this paper, the quality of the disclosure will depend in part on the value placed on governance and on governance disclosure by the issuer and by the rigor with which the CSA reviews the disclosure and the steps taken to remedy deficient disclosure.

It should be noted that these additional disclosure requirements will be imposed on smaller issuers without any further guidance about how smaller issuers should approach their governance practices. Whether or not it is the CSA that is best positioned to provide this guidance, it will require much more effort on the part of smaller issuers and their shareholders to develop an understanding of governance practices that are both effective and in respect of which the benefits do not outweigh the costs.

9. Threshold Questions

The CSA's Request for Comment raises some important questions with respect to the specifics of their proposals. It will be of great benefit to the final iteration of any amendment for as many stakeholders as possible to respond thoughtfully to the questions raised.

This paper poses several threshold questions with respect to the CSA initiative generally. It will also be helpful for stakeholders to express their views on these issues in their comments to the CSA.

- Will the changes being proposed enhance the standard of governance and confidence in the Canadian capital markets sufficiently to justify the costs to issuers and investors of moving to a new regime?
- Should the Current Policy and Current Disclosure Requirements be revised at this time?
- Is the CSA the appropriate body to be setting governance standards for Canadian public companies. With the much broader base of interest and expertise in corporate governance today than ever before, should Canadians be following the example set in the UK, Australia and South Africa?

This paper has been prepared to promote debate and discussion in the director community in advance of the April 20 deadline for comments to the CSA. Directors are invited to contact the author (chansell@dwpv.com or 416-863-5592) to discuss any of the issues raised in this paper. Directors are also encouraged to provide their comments to the CSA directly or through the coordinating efforts of the Institute of Corporate Directors.

APPENDIX A

Nine Core Corporate Governance Principles

- Principle 1 - Create a framework for oversight and accountability
  An issuer should establish the respective roles and responsibilities of the board and executive officers.

- Principle 2 - Structure the board to add value
  The board should be comprised of directors that will contribute to its effectiveness.

- Principle 3 - Attract and retain effective directors
  A board should have processes to examine its membership to ensure that directors, individually and collectively, have the necessary competencies and other attributes.

- Principle 4 - Continuously strive to improve the board's performance
  A board should have processes to improve its performance and that of its committees, if any, and individual directors.

- Principle 5 - Promote integrity
  An issuer should actively promote ethical and responsible behavior and decision-making.

- Principle 6 - Recognize and manage conflicts of interest
  An issuer should establish a sound system of oversight and management of actual and potential conflicts of interest.

- Principle 7 - Recognize and manage risk
  An issuer should establish a sound framework of risk oversight and management.

- Principle 8 - Compensate appropriately
  An issuer should ensure that compensation policies align with the best interests of the issuer.

- Principle 9 - Engage effectively with shareholders
  The board should endeavor to stay informed of shareholders' views through the shareholder meeting process as well as through ongoing dialogue.

APPENDIX B

Principle 7 – Recognize and Manage Risk

Principle 7 – Recognize and manage risk
An issuer should establish a sound framework of risk oversight and management.

Commentary

Risk oversight and management include the culture, processes and structures that are directed towards taking advantage of potential opportunities while managing potential adverse effects. It usually is designed to identify, assess, monitor and manage risk, and identify significant changes to an issuer's risk profile.

Risk oversight and management is most effective if it is embedded into the issuer's practices and business processes rather than if it is viewed or practiced as a separate activity.

Risk oversight and management should focus on identifying the most significant areas of uncertainty or exposure that could have an adverse impact on the achievement of the issuer's goals and objectives (principal risks).

As stated in Principle 1, the board is usually responsible for identifying the principal risks of the issuer's business and ensuring that appropriate systems are in place to manage these risks. A board committee could facilitate meeting this responsibility. The responsibility for risk oversight and management, however, rests with the full board.

Examples of practices

The objective of this principle can be achieved in a number of ways, including by:

(a) developing, approving and implementing policies and procedures for the oversight and management of principal risks that:

  (i) reflect the issuer's risk profile;

  (ii) clearly describe significant elements of its risk management;

  (iii) take into account its legal obligations; and

  (iv) clearly describe the roles and accountabilities of the board, audit committee, or other appropriate board committee, management and any internal audit function.

(b) regularly reviewing and evaluating the effectiveness of these policies and procedures; and

(c) requiring the CEO and other executive officers to regularly report to the board on the effectiveness of the issuer's policies for the oversight and management of principal risks.

Disclosure Requirement

(a) Disclose a summary of any policies on risk oversight and management adopted by the issuer.

APPENDIX C

Principle 8 – Compensate Appropriately

Principle 8 – Compensate appropriately
An issuer should ensure that compensation policies align with the best interests of the issuer.

Commentary

The board should be satisfied that appropriate compensation policies and practices are in place for executive officers and directors. Compensation should be set and structured to attract and retain executive officers and directors and motivate them to act in the best interests of the issuer. This includes a balanced pursuit of the issuer's short-term and long-term objectives.

A board compensation committee could develop and recommend appropriate compensation policies and practices.

The responsibility for these policies and practices, however, rests with the full board. Smaller boards might not need a formal committee to achieve the same objectives.

Transparency of compensation can promote investor understanding and confidence in the process.

Examples of practices

General practices

The objective of this principle can be achieved in a number of ways, including by:

(a) having procedures for:

(i) establishing and maintaining goals related to executive officers' compensation;

(ii) regularly evaluating executive officers' performance in light of those goals;

(iii) determining the compensation of executive officers;

(iv) determining the compensation of directors; and

(v) having the board review executive compensation disclosure before the issuer publicly discloses it; and

(b) establishing a compensation committee to carry out, or make recommendations with respect to, some or all of these procedures.

Practices related to compensation committee

Where an issuer has established a compensation committee, design that committee to:

(a) have all independent directors;

(b) have directors with the requisite competencies and other attributes to fulfill the mandate of the committee;

(c) have a charter that clearly sets out its roles and responsibilities, composition, structure and membership requirements;

(d) have the authority to engage and compensate any internal and external advisor that it determines to be necessary to permit it to carry out its duties; and

(e) have procedures to ensure that no individual is directly involved in deciding his or her own compensation.

Disclosure Requirement

(a) Describe any practices the issuer uses to establish and maintain appropriate compensation policies for executive officers and directors.

(b) If a compensation consultant or advisor has assisted the board or the compensation committee since the beginning of the issuer's most recently completed financial year:

(i) state the name of the consultant or advisor and a summary of the mandate it has been given;

(ii) disclose when the consultant or advisor was originally retained;

(iii) if the consultant or advisor has performed any other work for the issuer, state this fact and briefly describe the nature of the work; and

(iv) disclose the aggregate fees billed by the consultant or advisor in each of the last two financial years for:

(A) professional services relating to executive compensation; and

(B) professional services other than those relating to executive compensation. Include a description of the nature of the services comprising the fees disclosed under this category.