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Superintendent of Securities, Prince Edward Island
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Re: CSA Consultation Paper 52-404 – *Approach to Director and Audit Committee Member Independence* (the "Consultation Paper")

We welcome the opportunity to provide this submission concerning the appropriateness of the current approach of the Canadian Securities

Administrators (the **"CSA"**) to determining director and audit committee member independence. Our Board takes matters of corporate governance very seriously and Power Financial Corporation (**"Power Financial"**) and its affiliates are active participants in the public dialogue regarding corporate governance in Canada.

Executive Summary

We believe the current regulatory approach to determining director independence is overly restrictive and inflexible, and, as such, not appropriate for all issuers in the Canadian market. The provisions deeming directors that are related to a parent (i.e., the controlling shareholder) of an issuer to be non-independent are not an appropriate response to any potential governance concerns they are intended to address. Being overly-broad, the provisions concerning independence determinations encompass directors who have no direct or indirect relationship with the issuer which could, in the view of the issuer's board of directors, be reasonably expected to interfere with the exercise of the director's independent judgment. While such a regime may have the advantage of being predictable in its application, its benefits are far outweighed by its negative effect, in particular with respect to family controlled companies. As discussed further herein, we recommend replacing the current director independence regime with a more flexible one, in which the independence determinations are made by the board on a case-by-case basis without reference to any deeming provisions.

The Power Group

Power Financial (TSX: PWF) is a diversified management and holding company with interests in companies in the financial services sector in Canada, the United States and Europe. We are major long-term shareholders of companies, including Canadian public company subsidiaries, such as Great-West Lifeco Inc. (TSX: GWO)[1] and IGM Financial Inc. (TSX: IGM)[2]. In addition, Power Financial is the principal asset of Power Corporation of Canada (TSX: POW), which holds an approximately 65.5% voting interest in Power Financial. In turn, Power Corporation of Canada has a controlling shareholder, the Desmarais Family Residuary Trust.

[1] Power Financial and IGM Financial Inc. hold 67.7% and 4.0%, respectively, of Great-West Lifeco Inc.'s common shares, representing, in aggregate, approximately 65% of the voting rights attached to all outstanding Great-West Lifeco Inc. voting shares.

[2] Power Financial and The Great-West Life Assurance Company, a subsidiary of Great-West Lifeco Inc., hold 61.5% and 3.8%, respectively, of IGM Financial Inc.'s common shares, representing, in aggregate, an approximately 65.3% voting interest in IGM Financial Inc.

It has been our practice for decades to take an active role in the oversight of our subsidiaries. Our interests are in seeing that our own shareholders, and indeed all our stakeholders, prosper over the long-term, in alignment with members of the public that have co-invested with us in our publicly-traded subsidiaries. We work with management of our subsidiaries toward this objective, with directors and officers of Power Financial serving on the boards and board committees of these subsidiaries. These directors have no relationship with the subsidiaries other than as directors and shareholders, and the full-time job of a number of our officers is to focus on and become knowledgeable about the affairs of the subsidiaries.

We think this approach works well as executives of Power Financial are well placed to represent the interests of all shareholders in interacting with management at the board level. In our view, it is because of this approach that many shareholders invest in Power Financial and in our publicly-traded subsidiaries.

Determination of Independence

National Instrument 52-110 – Audit Committees (**"NI 52-110"**) provides that a director is "independent" of an issuer if he or she has no direct or indirect relationship with the issuer which could, in the view of the issuer's board of directors, be reasonably expected to interfere with the exercise of the director's independent judgment. We agree with this approach to assessing director independence.

However, NI 52-110 further provides that a director is deemed to have such a direct or indirect relationship with an issuer (and thus not to be independent) if, among other things, the director is, or has been within the last three years, an executive officer or an employee of the issuer's controlling shareholder. We disagree with this approach.

As noted in the Consultation Paper, the definition of independence is a central component of the Canadian corporate governance regime. First, NI 52-110 requires the Audit Committee of non-venture issuers to be composed solely of independent directors. Furthermore, the definition of independence is also relevant to National Policy 58-201, which provides guidance that nominating and compensation committees should be comprised entirely of independent directors, and to the "comply or explain" regime established under Form 1 of National Instrument 58-101 – Disclosure of Corporate Governance Practices (**"Form 58-101F1"**).

We believe the determination of director independence should be factual, protecting the interests of all shareholders based on actual relationships with management, while also being contextual, providing enough flexibility for diverse companies to tailor governance to their specific circumstances. As explained below, the current regime for determining director independence suffers from being overly-restrictive and inflexible.

Impact of the Current Definition of Independence

The automatic deeming provisions result in a one-size-fits-all regime which is inconsistent with the history of the CSA's principles-based approach to corporate governance and which does not provide the necessary flexibility required to meet the needs of a diverse and increasingly innovative Canadian corporate issuer market. By imposing a rigid and narrow definition of independence, designed for widely-held public companies, the CSA indirectly penalize family-controlled companies and corporate groups such as ours, who choose to tailor their governance structure to their particular context.

Within the Power group, our governance model, which has been developed over many decades, provides for the inclusion of parent officers (and directors) on boards of subsidiary companies. We believe that the participation of the controlling shareholder is beneficial to all stakeholders. A controlling shareholder is able to support management in the pursuit of long-term strategies and to provide directors who are experienced and knowledgeable about the business of the subsidiary. Serving as a director of a subsidiary is an extension of the role as an officer of the parent shareholder and assists such person in discharging their corporate law duties by focusing on and being knowledgeable about the affairs of the subsidiary. Meanwhile, the interests of the parent are well served by the experience of and expertise in the affairs of group companies brought to the parent by those officers who also serve on the boards of its subsidiaries. The presence of our officers and directors on our subsidiaries' boards assists our board in the proper stewardship of our holdings, enriches the discussion, and enhances the quality of governance, at both our board and our subsidiaries' boards.

Furthermore, we believe it is appropriate for officers of the parent to be members of the subsidiary's key committees (i.e. Audit, Nominating and Compensation Committees), to provide the knowledge and perspective of the controlling shareholder with respect to the matters under the responsibility of such committees. However, the current regime established by NI 52-110 inappropriately prevents us from including an executive officer of Power Financial (e.g., our Chief Financial Officer) on the Audit Committees of our public subsidiaries. We believe that, given our corporate structure, our Chief

Financial Officer would provide an important, value-added perspective and independent oversight with respect to financial matters at our public subsidiaries, for the benefit of all shareholders.

Similarly, Power Financial and its public subsidiaries are made to appear to be "non-compliant" under the "comply or explain" regime established by Form 58-101F1, because of the presence of parent officers (deemed non-independent) on the Nominating and Compensation Committees at Great-West Lifeco Inc. and IGM Financial Inc. This gives an inappropriate and misleading impression to the marketplace, as our officers sitting on our publicly-traded subsidiaries' boards and key committees are deemed to be non-independent when in fact they do not have any direct or indirect relationship with the issuer which could, in the view of the issuer's board of directors, be reasonably expected to interfere with the exercise of the director's independent judgment.

The CSA's strict regime with respect to director independence on board and key committees has been adopted by a number of governance stakeholders, including governance rankings and proxy advisory firms and has resulted in negative perceptions, lower governance scores and adverse voting recommendations for Power Financial and its group companies. We find this troublesome given that we seek to meet the highest standards of governance.

The Value of Family-Controlled Businesses and the Need for a More Flexible Governance Framework

There is no single model of good corporate governance and the structures and practices that are most appropriate vary among issuers. It is therefore important that the CSA not be overly prescriptive in the definition of independence, but rather facilitate the ability of public issuers to arrange their governance structures in ways that they determine as being appropriate to their particular circumstances and to adapt such structures as their business evolves over time. This also allows investors a wider choice of investments and governance models.

As noted by various governance commentators, including the Clarkson Centre for Board Effectiveness ("**CCBE**"), family-controlled firms are subject to very different realities from widely-held firms. As a consequence, because they do not conform to a one-size-fits-all governance framework, especially with respect to director independence, "they tend to be discounted from discussions about the best-governed firms." However, as CCBE points out, "family firms often appear best able to create value for their shareholders

when they choose not to adhere to typical best practices in share structure and independence".[3]

Family-controlled businesses are the cornerstone of the Canadian economy, with some 90% of companies in Canada being estimated to be family-owned, generating 60% of Canada's GDP.[4] This includes a significant presence in larger businesses, where 10 of Canada's 25 largest employers are family-controlled.[5]

Family control provides unique and inherent advantages, the most important of which is the ability to focus on long-term sustainable profitability. A financially strong and long-term oriented controlling shareholder is aligned with the interests of other shareholders in this respect and can have a significant positive impact on a corporation's long-term returns, benefiting all shareholders and the corporation as a whole. As noted by Robert Monks, the founder of Institutional Shareholder Services ("**ISS**"), "in Canada, you have several examples of responsible ownership: The Westons, Thompsons, Desmarais and Irvings easily come to mind. [...] when a leader has a personal brand at stake, as owners do, they behave differently. Responsible owners are accountable. They're vulnerable to the consequences of their company's actions and outcome. So they care, and make corporate decisions with both the business and their conscience in mind. [...] It's better to have owners who are dedicated to the business, able to sustain a long-term visions and apply their personal values to the enterprise."[6]

According to a study by National Bank of Canada: "Over the last 10 years, large Canadian family-controlled public companies have outperformed the S&P/TSX Composite Index by 120%", with total shareholder returns of 192.0% (11.3% per year) compared to 71.7% (5.6% per year).[7] The study cites longer-term tenures for senior management, superior branding and reputation, the ability to make quicker decisions and the loyalty of employees as some of the other factors which contribute to the outperformance of family firms. Similarly, the CCBE found that "Canadian family-controlled issuers have performed better than their peers over the past 15 years, greatly

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[3] "The Impact of Family Control on the Share Price Performance of Large Canadian Publicly-Listed Firms (1998-2012)", Clarkson Centre for Board Effectiveness at the Rotman School of Management, University of Toronto, June 2013.

[4] "Family business in North America: Facts and figures", EY Family Business Yearbook, 2014.

[5] "Business Families: building a brighter future", Creaghan McConnell Group, 2014.

[6] Listed (David W. Anderson), Summer 2013, pages 33-37).

[7] "The Family Advantage – The Sustainable Outperformance of Canadian Family-Controlled Public Companies", National Bank of Canada, October 2015.

benefitting minority shareholders", while noting that the performance gap "suggests that family-controlled issuers are benefitting from their longer-term outlook, and perhaps also from their unique governance structure".[3] Furthermore, a McKinsey & Company article comments on the same topic as follows: "what's noteworthy about [family businesses'] performance is asset productivity and brand value: their asset turnover, or ratio of revenues to invested capital, is roughly twice that of other companies, and they account for 80 percent of the brand value of the world's most valuable labels".[8]

Also, family-controlled companies have been increasing their presence among global businesses and are expected to continue to do so over the next decade. In 2014, family-controlled companies made up 19 per cent of the companies in the *Fortune* Global 500 (which tracks the world's largest companies by sales), up from 15 per cent in 2005. By 2025, they are expected to increase their share of the *Fortune* Global 500 group to 40 per cent.[9]

In light of the above, we strongly believe that the current approach to director and committee member independence should be revised to permit family-controlled companies to adopt appropriately-customized governance frameworks that are based on factual circumstances and are aligned with and protect shareholder interests within the particular context of such issuers.

Conflicts of Interests and Protection of Minority Shareholders

With regard to protection of the interests of minority shareholders, deeming individuals with a relationship with a controlling shareholder to be non-independent directors of the controlled issuer inappropriately casts an overly-broad net, resulting in unnecessary negative consequences, as discussed above.

Securities laws in Canada already provide a robust regime of minority protections in Multilateral Instrument 61-101 – Protection of Minority Security Holders in Special Transactions (**"MI 61-101"**), requiring a separate approval of certain related party transactions and business combinations by a vote of disinterested minority shareholders, formal valuations, and including augmented and detailed disclosure requirements for proxy circulars concerning such shareholder meetings and any related material change reports. MI 61-101 also mandates the involvement of a special committee of

[8] "Fine-tuning family businesses for a new era", McKinsey & Company (Åsa Björnberg, Ana Karina Dias, and Heinz-Peter Elstrodt), October 2016.
[9] The Economist, *Business in the Blood – Family Firms*, November 1, 2014, available at https://www.economist.com/news/business/21629385-companies-controlled-founding-families-remain-surprisingly-important-and-look-set-stay

independent directors in specific circumstances and the Companion Policy to MI 61-101 recommends their use in all material conflict of interest transactions, while Multilateral CSA Staff Notice 61-302 – Staff Review and Commentary on Multilateral Instrument 61-101 Protection of Minority Security Holders in Special Transactions provides extensive guidance regarding such committees and their mandates.

Furthermore, it is important to be mindful of the legal requirement that all directors must always act with regard to the best interests of the corporation as a whole, including its shareholders generally, and not any single shareholder or any shareholder group. This duty is undiminished by any relationship a director may have with a controlling shareholder, such as acting as an officer of the shareholder. Such directors must identify what they regard as the best interests of the controlled company, whether this interest conflicts with or coincides with the best interests of a particular shareholder.

In most cases, the best interests of a controlled company will be consistent with the interests of a controlling shareholder, which interests will also be aligned with the interests of minority shareholders: the creation and preservation of long-term shareholder value.

The potential governance issues (which are sometimes referred to) typically associated with controlling shareholders are not ones of "independence" but rather relate to conflicts of interests and self-dealing. Any such concerns which may exist in a controlled company should be resolved directly through a process involving only directors who are independent of the controlling shareholder and the controlled company (e.g., a committee of independent directors). Accordingly, our governance model includes such a committee, the Related Party and Conduct Review Committee, at Power Financial and each of our publicly-traded subsidiaries. This Committee reviews any transaction between the controlling shareholder and the controlled entity to ensure that the transaction is done at market terms and conditions.

Such a mechanism provides for a precise response to a potential governance weakness and can be expected to be more effective in addressing any self-dealing or conflicts issues than the overly-broad definition of independence.

The interests of minority shareholders are not imperilled by providing that directors with a relationship with a controlling shareholder can be considered to be independent directors of the controlled issuer (as long as these directors do not have any other relationship with the controlled issuer other than as directors thereof). This view is supported by the approach taken in other jurisdictions, as identified in the CSA Consultation Paper, wherein there is an absence of

evidence that such approach has been in any way detrimental to the capital markets in such jurisdictions.

Recommended Approach

The definition of independence should be adjusted to provide broader regulatory flexibility, while providing proper protection for all stakeholders involved.

The determination of director independence should be based upon whether or not the director (i) is independent of the issuer's management, and (ii) has any other relationships with the issuer which could reasonably be expected to interfere with the exercise of the director's independent judgment. Independence is a question of fact that should be determined by the issuer's board of directors, on a case-by-case basis, and without reference to any presumptions such as those currently contained in NI 52-110. Directors with a relationship with a controlling shareholder should not be considered to be non-independent by definition.

With such a revised methodology for determining independence, under the "comply or explain" regime established under Form 58-101F1 and the guidance provided by National Policy 58-201, independent directors with relationships with a controlling shareholder could sit on a controlled company's nominating and compensation committees and, under NI 52-110, could sit on a controlled company's audit committee.

Alternative Approach

Many investors expect controlling shareholders to have substantial influence over the strategic direction of the company, the election of directors, the appointment of executives, the financial affairs of the business and executive compensation. If the CSA are unwilling to remove relationships with a controlling shareholder from the non-independence deeming provisions, NI 52-110 should be, at a minimum, updated to distinguish between directors that have a relationship with an issuer's management, and directors that have a relationship with the controlling shareholder, but are independent of the issuer's management (i.e., a "**Related Director**"), while Form 58-101F1 and National Policy 58-201 – Corporate Governance Guidelines ("**NP 58-201**") should at a minimum be updated to recognize the alternate forms of good governance practices at controlled companies.

- Item 1 of Form 58-101F1 and Section 3.1 of NP 58-201 currently provide that a Board of Directors should have a majority of

independent Directors. In our view, a controlled company's board should include both independent directors and Related Directors. The determination of the appropriate number of each category of director should be made by the board of directors of the issuer, based on its own particular circumstances.

- Item 6(b) of Form 58-101F1 and Section 3.10 of NP 58-201 currently provide that the Nominating Committee should be composed entirely of independent directors, while Item 7(b) of Form 58-101F1 and Section 3.15 of NP 58-201 currently provide that the Compensation Committee should be composed entirely of independent directors. In our view, it is normal and appropriate in the case of a company with a controlling shareholder, to have Related Directors as members of the subsidiary Board committees (to provide knowledge and perspective of the controlling shareholder with respect to executive compensation, appointments and board nominations), as well as independent directors. The determination of the appropriate number of each category of director on the Nominating and Compensation Committees should be made by the board of directors of the issuer, based on its own particular circumstances.

- Further, Section 3.1(3) of NI 52-110 should be revised to permit Related Directors to sit on an issuer's audit committee. Such Related Directors can provide important, value-added perspective to both the subsidiary issuer and the parent with respect to financial matters. The determination of the appropriate number of each category of director on the audit committee should be made by the board of directors of the issuer, based on its own particular circumstances. Failing the foregoing changes, Section 3.3 of NI 52-110 (which provides a limited allowance for parent company officers to sit on a subsidiary issuer's audit committee) should be amended to remove the qualification pre-requisite that the proposed audit committee member not be an officer of an affiliated issuer whose securities are traded on a marketplace. Section 3.3 already recognizes that one size does not fit all and alternate forms of audit committee composition can be appropriate in different contexts. However, it is unclear why having the affiliated issuer's securities being traded on a marketplace diminishes the acknowledged legitimacy of participation on an issuer's audit committee by a director who is an officer of such an affiliated issuer.

The foregoing differences are already recognized as acceptable alternative forms of good governance by many commentators that distinguish between directors that have a relationship with an issuer's management and directors that

have a relationship with the controlling shareholder, but are independent of the issuer's management, including the Canadian Coalition for Good Governance's ("**CCGG**"), in their policy *Governance Differences for Equity Controlled Corporations*, which, in order to "take into account the legitimate governance differences of equity controlled corporations", also provides for greater participation by Related Directors on the Board[10] and committees[11] of a controlled company. For example, CCGG is of the view that "given their connection to the Controlling Shareholder, Related Directors can bring an important perspective to the audit committee which may add value to the Controlled Corporation." A similar approach is taken by certain institutional investors, including the Caisse de dépôt et placement du Québec[12], and by proxy advisory firms ISS[13] and Glass Lewis[14].

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[10] "The number of Related Directors of a Controlled Corporation should not exceed the proportion of the common shares controlled by the Controlling Shareholder, to a maximum of two thirds. However, if the CEO is related to the Controlling Shareholder, then at least two thirds of the directors of a Controlled Corporation should be Independent Directors."

[11] "At least one member of each board committee of a Controlled Corporation should be an Independent Director. In addition, a majority of the members of all board committees (with the exception of the compensation committee) should be either Independent Directors or Related Directors who are independent of management of the Controlled Corporation. All members of the compensation committee should be independent of management of the Controlled Corporation. In addition, if the CEO is related to the Controlling Shareholder, no more than one member of the compensation committee should be a Related Director."

[12] The *Policy on the Principles Governing the Exercise of Voting Rights of Public Companies* of the Caisse de dépôt et placement du Québec provides that "[...] when a shareholder holds a large block of shares, the nomination (or governance) and compensation (or human resources) committees must be made up entirely of members who are independent of the company, with the majority of these members also independent of the shareholder who holds a large block of shares."

[13] ISS's latest *Proxy Voting Guidelines for TSX-Listed Companies* (at "Policy Considerations for Majority Owned Companies") provide that for qualifying controlled companies, "The number of directors related to the controlling shareholder should not exceed the proportion of common shares controlled by the controlling shareholder. [...] A majority of the audit and nominating committees should be either independent directors or related directors who are independent of management. All members of the compensation committee should be independent of management."

[14] In its latest *An Overview of the Glass Lewis Approach to Proxy Advice – Canada* (at "Controlled Companies"), Glass Lewis provides that, "The board of directors' function is to protect the interests of shareholders; however, when a single individual or entity owns more than 50% of the voting shares, the interests of the majority of shareholders are the interests of that entity or individual. Consequently, Glass Lewis does not recommend withholding votes from boards whose composition reflects the makeup of the shareholder population. In other words, affiliated directors and insiders who are associated with the controlling entity are not subject to our standard independence thresholds. [...] The compensation, nominating and governance committees do not need to consist solely of independent directors."

Even as far back as the 1994 Report of the Toronto Stock Exchange Committee on Corporate Governance in Canada (the "**Dey Report**"), it was recognized that governance, as a "dynamic concept", was not a one-size-fits-all proposition and that, in particular, directors with a relationship with a company's controlling shareholder could still be independent of the controlled company, comprise a significant proportion of the board and sit on the nominating and compensation committees of the controlled company, together with directors who are independent of the issuer and the controlling shareholder.

Conclusion

We fully endorse the proposed removal of the "bright line" tests that result in directors with a relationship with a controlling shareholder automatically being deemed to be non-independent of the subsidiary issuer. "Independence" should mean independence from the issuer and its management, and relationships between a controlling or significant shareholder and the issuer can and should be effectively addressed through the recognition and supervision of conflicts of interest. This change takes into account the realities of Canada's capital markets and its significant proportion of controlled companies.

In the alternative, NI 52-110, Form 58-101F1 and NP 58-201 should be updated to distinguish between directors that have a relationship with an issuer's management, and directors that have a relationship with the controlling shareholder, but are independent of the issuer's management, recognizing the value such Related Directors can bring to an issuer's board and committees.

Representatives of Power Financial would be pleased to discuss the foregoing with representatives of the CSA if that would be of assistance.

Yours very truly,