

## 6.1.2 Proposed Multilateral Policy 58-201 Effective Corporate Governance

### PROPOSED MULTILATERAL POLICY 58-201 EFFECTIVE CORPORATE GOVERNANCE

#### Part One Introduction

**1.1 Background and Purpose of this Policy** - (1) This Policy represents one step in the evolution of corporate governance standards and practice. In 1994, a committee sponsored by the Toronto Stock Exchange (the TSX) published a report entitled *Where Were the Directors?* (the Dey Report). The Dey Report contained 14 recommendations to assist TSX-listed companies in their approach to corporate governance. In 1995, the TSX adopted the 14 recommendations as “best practice guidelines” and required every listed company to disclose annually their approach to corporate governance with reference to the guidelines, together with an explanation of any differences between the company’s approach and the guidelines. The guidelines were not intended to be mandatory.

In 1999, the Institute of Corporate Directors and the TSX sponsored a report entitled *Five Years to the Dey*, which evaluated how Canadian companies were complying with the Dey Report’s best practice guidelines. The report concluded that, although most companies took the guidelines seriously, important areas remained where general practice fell short of the guidelines’ intent.

Subsequently, the Canadian Institute of Chartered Accountants (the CICA), the TSX, and the TSX Venture Exchange (then the Canadian Venture Exchange) established the Joint Committee on Corporate Governance in July 2000 (the Saucier Committee). The mandate of the Saucier Committee was to review the state of corporate governance in Canada and recommend changes in this area. The Saucier Committee’s final report, released in November 2001, recommended that the TSX amend its corporate governance guidelines in a number of ways to bring them into line with international developments. On April 26, 2002, the TSX proposed changes to its guidelines for effective corporate governance in response to the Saucier Committee’s recommendations.

In July, 2002, the *Sarbanes-Oxley Act* (SOX) was enacted in the United States. SOX prescribed a broad range of measures designed to restore the public’s faith in the U.S. capital markets in the wake of several U.S. financial reporting scandals. Recognizing the global implications of U.S. reforms, particularly for Canadian capital markets, we initiated a review of the reforms that had been proposed or implemented in the U.S. and elsewhere for the purpose of considering whether we should adopt them in Canada. During the period of review, there have been a number of regulatory developments including, most recently, the approval of revised listing standards of the New York Stock Exchange and the Nasdaq Stock Market in November, 2003. At the same time, a number of Canadian institutional investors and other organizations have significantly influenced governance practices through proxy voting guidelines that focus on governance matters and by influencing the establishment of best practices.

This Policy has been adopted by the securities regulatory authorities in Ontario, Saskatchewan, Alberta, Manitoba, Nova Scotia, New Brunswick, Prince Edward Island, Newfoundland and Labrador, the Yukon Territory, the Northwest Territories and Nunavut. The purpose of the Policy is to confirm as best practice certain governance standards and guidelines that have evolved through the confluence of legislative and regulatory reforms and the initiatives of other capital market participants. In developing the policy, we recognize that our Canadian approach to corporate governance must:

- achieve a balance between providing protection to investors and fostering fair and efficient capital markets and confidence in capital markets;
- be sensitive to the realities of the greater numbers of small companies and controlled companies in the Canadian corporate landscape;
- take into account the impact of developments in the U.S. and around the world; and
- recognize that corporate governance is in a constant state of evolution.

**1.2 Application of this Policy** – This Policy provides guidance on corporate governance practices. The recommendations in this Policy are not intended to be prescriptive. We encourage issuers to adopt the suggested measures, but they should be implemented flexibly and sensibly to fit the situation of individual issuers.

**1.3 Non-Corporate Entities** – This Policy applies to all reporting issuers, other than investment funds. Consequently, it applies to both corporate and non-corporate entities. Where this Policy refers to a particular corporate characteristic,

such as a board of directors (the board), the reference should be read to also include any equivalent characteristic of a non-corporate entity.

*E.g.*, In the case of an income trust, we recommend that a majority of the trustees be independent of the trust and the underlying business. Similarly, in the case of a limited partnership, we recommend that a majority of the directors of the general partner be independent of the limited partnership (including the general partner).

## **Part Two Effective Corporate Governance**

**2.1 Meaning of Independence** – For the purposes of this Policy, a director is independent if he or she has no direct or indirect material relationship with the issuer. A “material relationship” is a relationship which could, in the view of the issuer’s board, reasonably interfere with the exercise of a director’s independent judgement. However, an individual described in subsection 1.4(3) of Multilateral Instrument 52-110 *Audit Committees* (other than an individual described in clauses 1.4(3)(f)(i) or (g) of that instrument) is considered to have a material relationship with the issuer.

**2.2 Recommended Best Practices –**

### **Composition of the Board**

1. The board should be composed of a majority of independent directors.
2. The independent board members should hold separate, regularly scheduled meetings at which members of management are not in attendance.
3. The chair of the board should be an independent director. Where this is not appropriate, an independent director may be appointed to act as “lead director”. However, either the independent chair or independent lead director should act as the effective leader of the board and ensure that the board’s agenda will enable it to successfully carry out its duties.

### **Board Mandate**

4. The board should adopt a written mandate in which it explicitly assumes responsibility for the stewardship of the issuer, including responsibility for:
  - (a) to the extent feasible, satisfying itself as to the integrity of the chief executive officer (the CEO) and other senior officers and that the CEO and other senior officers create a culture of integrity throughout the organization;
  - (b) adopting a strategic planning process and approving, on at least an annual basis, a strategic plan which takes into account, among other things, the opportunities and risks of the business;
  - (c) identifying the principal risks of the issuer’s business, and ensuring the implementation of appropriate systems to manage these risks;
  - (d) succession planning (including appointing, training and monitoring senior management);
  - (e) adopting a communication policy for the issuer;
  - (f) ensuring the integrity of the issuer’s internal control and management information systems; and
  - (g) developing the issuer’s approach to corporate governance, including developing a set of corporate governance principles and guidelines that are specifically applicable to the issuer.<sup>1</sup>

The written mandate of board should also set out

- (i) the decisions requiring prior approval of the board,
- (ii) measures for receiving feedback from security holders, and

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<sup>1</sup> Issuers may consider appointing a corporate governance committee to consider these issues. A corporate governance committee should be comprised of a majority of independent directors, with the remaining members being “non-management” directors.

- (iii) the board's expectations of management.

In developing an effective communication policy for the issuer, issuers should also refer to the guidance set out in National Policy 51-201 *Disclosure Standards*.

#### **Position Descriptions**

5. The board should develop clear position descriptions for directors, including the chair of the board and the chair of each board committee. In addition, the board, together with the CEO, should develop a clear position description for the CEO, which includes delineating management's responsibilities. The board should also develop or approve the corporate goals and objectives that the CEO is responsible for meeting.

#### **Orientation and Continuing Education**

6. The board should ensure that all new directors receive a comprehensive orientation. All new directors should fully understand the role of the board and its committees, as well as the contribution individual directors are expected to make (including, in particular, the commitment of time and energy that the issuer expects from its directors).<sup>2</sup> All new directors should also fully understand the nature and operation of the issuer's business.
7. The board should provide continuing education opportunities for all directors, so that individuals may maintain or enhance their skills and abilities as directors, as well as to ensure their knowledge and understanding of the issuer's business remains current.

#### **Code of Business Conduct and Ethics**

8. The board should adopt a written code of business conduct and ethics (a Code). The Code should be applicable to directors, officers and employees of the issuer. The Code should constitute written standards that are reasonably designed to deter wrongdoing and address the following issues:
- (a) conflicts of interest;
  - (b) protection and proper use of corporate assets and opportunities ;
  - (c) confidentiality of corporate information;
  - (d) fair dealing with the issuer's security holders, customers, suppliers, competitors and employees;
  - (e) compliance with laws, rules and regulations; and
  - (f) reporting of any illegal or unethical behavior.
9. The board should be responsible for monitoring compliance with the Code. Any waivers from the Code that are granted for the benefit of the issuer's directors or senior officers should be granted by the board (or a board committee) only.

#### **Nomination of Directors**

10. The board should appoint a nominating committee composed entirely of independent directors.
11. The nominating committee should have a written charter that clearly establishes the committee's purpose, responsibilities, member qualifications, member appointment and removal, structure and operations (including any authority to delegate to individual members and subcommittees), and manner of reporting to the board. In addition, the nominating committee should be given authority to engage and compensate any outside advisor that it determines to be necessary to permit it to carry out its duties. If an issuer is legally required by contract or otherwise to provide third parties with the right to nominate directors, the selection and nomination of such directors need not involve the approval of an independent nominating committee.
12. Prior to nominating or appointing individuals as directors, the board should adopt the following two step process:

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<sup>2</sup> It is expected that issuers will only recruit those individuals who have sufficient time and energy to devote to the task.

Step One. Consider what competencies and skills the board, as a whole, should possess. In doing so, the board should recognize that the particular competencies and skills required for one issuer may not be the same as those required for another.

Step Two. Assess what competencies and skills each existing director possesses. It is unlikely that any one director will have all the competencies and skills required by the board. Instead, the board should be considered as a group, with each individual making his or her own contribution. Attention should also be paid to the personality and other qualities of each director, as these may ultimately determine the boardroom dynamic.

The board should also consider the appropriate size of the board, with a view to facilitating effective decision-making.

In carrying out each of these functions, the board should consider the advice and input of the nominating committee.

13. The nominating committee should be responsible for identifying individuals qualified to become new board members and recommending to the board the new director nominees for the next annual meeting of shareholders.
14. In making its recommendations, the nominating committee should consider:
  - (a) the competencies and skills that the board considers to be necessary for the board, as a whole, to possess;
  - (b) the competencies and skills that the board considers each existing director to possess; and
  - (c) the competencies and skills each new nominee will bring to the boardroom.

#### **Compensation**

15. The board should appoint a compensation committee composed entirely of independent directors.
16. The compensation committee should have a written charter that establishes the committee's purpose, responsibilities, member qualifications, member appointment and removal, structure and operations (including any authority to delegate to individual members or subcommittees), and the manner of reporting to the board. In addition, the compensation committee should be given authority to engage and compensate any outside advisor that it determines to be necessary to permit it to carry out its duties.
17. The compensation committee should be responsible for:
  - (a) reviewing and approving corporate goals and objectives relevant to CEO compensation, evaluating the CEO's performance in light of those corporate goals and objectives, and making recommendations to the board with respect to the CEO's compensation level based on this evaluation;
  - (b) making recommendations to the board with respect to non-CEO compensation, incentive-compensation plans and equity-based plans; and
  - (c) reviewing executive compensation disclosure before the issuer publicly discloses this information.

#### **Regular Board Assessments**

18. The board should regularly assess its own effectiveness, as well as the effectiveness and contribution of each board committee and each individual director. An assessment should consider
  - (a) the board's written mandate,
  - (b) the charter of each board committee, and
  - (c) the position description(s) applicable to each individual director, as well as the competencies and skills each individual director is expected to bring to the board.