

6.1.2 Notice - Request for Comment - Proposed Amendments to Multilateral Instrument 52-110 Audit Committees, Form 52-110F1, Form 52-110F2, and Companion Policy 52-110CP

NOTICE  
REQUEST FOR COMMENT

PROPOSED AMENDMENTS TO  
MULTILATERAL INSTRUMENT 52-110 AUDIT COMMITTEES, FORM 52-110F1,  
FORM 52-110F2, AND COMPANION POLICY 52-110CP

This Notice accompanies proposed amendments (the **Amendments**) to Multilateral Instrument 52-110 *Audit Committees*, Form 52-110F1 and Form 52-110F2 (collectively, the **Audit Committee Rule**) and to Companion Policy 52-110CP to Multilateral Instrument 52-110 *Audit Committees* (the **Companion Policy**). The Amendments are being published for a 90 day comment period by the securities regulatory authorities in every province and territory in Canada, other than British Columbia (the **Participating Jurisdictions**).

**Background to the Audit Committee Rule**

The Audit Committee Rule and the Companion Policy were initiatives of the Participating Jurisdictions. The Audit Committee Rule was adopted as a rule in each of Alberta, Manitoba, Ontario, Nova Scotia and Newfoundland and Labrador, as a Commission regulation in Saskatchewan, as a policy in New Brunswick, Prince Edward Island and the Yukon Territory, and as a code in the Northwest Territories and Nunavut. The Companion Policy was implemented as a policy in Alberta, Manitoba, Ontario, Nova Scotia, Newfoundland and Labrador, Saskatchewan, New Brunswick, Prince Edward Island, the Yukon Territory, the Northwest Territories and Nunavut. Both the Audit Committee Rule and the Companion Policy came into force on March 30, 2004. In Québec, the Audit Committee Rule will be adopted as a regulation made under section 331.1 of *The Securities Act* (Québec) once it is approved, with or without amendment, by the Minister of Finance, and will come into force on the date of its publication in the *Gazette officielle du Québec* or on any later date specified in the regulation. The Companion Policy will be implemented as a policy in Québec.

The purpose of the Audit Committee Rule is to encourage reporting issuers to establish and maintain strong, effective and independent audit committees. We believe that such audit committees enhance the quality of financial disclosure made by reporting issuers, and ultimately foster investor confidence in Canada's capital markets. The purpose of the Companion Policy is to provide interpretative guidance for the application of the Audit Committee Rule.

The Audit Committee Rule is based upon similar audit committee requirements applicable in the United States. In particular, it is derived from the audit committee requirements administered by the U.S. Securities and Exchange Commission (the **SEC**), as well as the listing requirements of the New York Stock Exchange (**NYSE**) and Nasdaq Stock Market.

**Background to the Amendments**

We have proposed the Amendments for two principal reasons:

(i) *Clarification of the Definition of Independence*

The Audit Committee Rule contains a definition of independence that is generally applicable to audit committee members. In developing this definition, we attempted to parallel, as much as possible, the definitions of independence applicable to members of audit committees of US listed companies. In the United States, for an audit committee member to be considered independent, the member must satisfy two distinct requirements:

- (i) the member must be independent within the meaning of section (b)(1) of SEC Exchange Rule 10A-3 (the **SEC Independent Audit Committee Member Requirements**); and
- (ii) the member must be an independent director as defined by the listing requirements of the applicable exchange or market (the **Exchange Independent Director Requirements**).

Our definition of independence (found in section 1.4 of the current Audit Committee Rule) was designed to incorporate into a single set of requirements the key elements of each of the SEC Independent Audit Committee Member Requirements and the Exchange Independent Director Requirements.

Concurrently with publishing this notice, the securities regulatory authorities in every jurisdiction in Canada have also published for comment proposed National Policy 58-201 *Corporate Governance Guidelines* (the **Governance Policy**) and proposed National Instrument 58-101 *Disclosure of Corporate Governance*

*Practices* (the **Governance Disclosure Rule**). The purpose of the Governance Policy is to provide guidance on corporate governance practices. The purpose of the Governance Disclosure Rule is to provide greater transparency for the marketplace regarding issuers' corporate governance practices. Both the Governance Policy and the Governance Disclosure Rule use a definition of independence that is consistent with the Exchange Independent Director Requirements.<sup>1</sup>

A primary purpose of the Amendments is to divide the existing definition of independence in section 1.4 of the Audit Committee Rule into two separate sets of requirements: one corresponding to the SEC Independent Audit Committee Member Requirements, and the other to the Exchange Independent Director Requirements. This division permits a convenient cross-reference in the Governance Disclosure Rule and the Governance Policy to the Exchange Independent Director Requirements contained in the Audit Committee Rule.

(ii) *Update to the Definition of Independence*

On August 3 and August 30, 2004, the NYSE filed SR-NYSE-2004-41 (the **NYSE Amendments**) with the SEC, which proposes amendments to the corporate governance rules set out in Section 303A of the NYSE Listed Company Manual. The NYSE Amendments make a number of changes to the NYSE's corporate governance rules, most importantly those dealing with "bright line tests" for director independence. The Amendments reflect changes to the definition of independence that correspond to the changes proposed in the NYSE Amendments.

We have taken this opportunity to also propose certain other minor amendments to the Audit Committee Rule and Companion Policy.

## Summary and Discussion of the Amendments

The Amendments contain the following significant changes:

### 1. Subsection 1.3(4) of the Audit Committee Rule – Change to the "Safe Harbour"

Subsection 1.3(4) of the Audit Committee Rule provides a "safe harbour" in connection with the determination of a person or company's status as an "affiliated entity". Presently, that section states that a person will not be considered to be an affiliated entity of an issuer for the purposes of the Audit Committee Rule if the person:

- (a) owns, directly or indirectly, ten per cent or less of any class of voting securities of the issuer; and
- (b) is not an executive officer of the issuer.

However, as drafted, this "safe harbour" is broader than intended. The Amendments therefore revise this section by deleting the words "be an affiliated entity of" and substituting the word "control".

In light of this change, the Amendments also include a consequential change to section 3.3 of the Companion Policy.

### 2. Section 1.4 of the Audit Committee Rule – Definition of Independence

The Amendments replace section 1.4 of the Audit Committee Rule with two new sections dealing with the meaning of independence. As noted above, the existing definition of independence is an amalgam of the SEC Independent Audit Committee Member Requirements and the Exchange Independent Director Requirements. However, to facilitate the use of the Exchange Independent Director Requirements for both the Governance Disclosure Rule and Governance Policy, we re-drafted our definition of independence into two sections, section 1.4 (which contains the Exchange Independent Director Requirements) and section 1.5 (which contains the SEC Independent Audit Committee Member Requirements). To be considered independent for the purposes of the revised Audit Committee Rule, an audit committee member will be required to satisfy the requirements in both section 1.4 and 1.5.

In addition, the Amendments modify that portion of our definition derived from the Exchange Independent Director Requirements in the following manner:

- we have revised certain of the prescribed relationships to more closely parallel those proposed in the NYSE Amendments, (see subsection 1.4(3), generally, and paragraphs 1.4(3)(c) & (d) in particular)

---

<sup>1</sup> The SEC Independent Audit Committee Member Requirements apply only in the context of audit committees.

- we have clarified the definition as it applies to part time chairs and their immediate family members, (see subsection 1.4(7))
- we have removed the concept of a “prescribed period”, and replaced it with a simpler, clearer transition provision which has the same effect, and (see subsection 1.4(4))
- we have added subsection 1.4(8), which indicates that for the purpose of section 1.4, a reference to an “issuer” includes an issuer’s parent entity and subsidiary entities.

In light of these changes, the Amendments also include consequential changes to sections 3.1 and 3.2 of the Companion Policy.

### 3. Form 52-110F2 – Disclosure of Relevant Education and Experience

Form 52-110F2 has been revised to require venture issuers to provide additional disclosure regarding the education and experience of their audit committee members. Currently, this disclosure is only required for issuers other than venture issuers. However, we now believe that it would be useful for all issuers to provide this disclosure.

### 4. Companion Policy – Application of Audit Committee Rule to Income Trusts

The Amendments revise that portion of section 1.2 of the Companion Policy which deals with income trusts. The revisions harmonize the treatment of income trusts under the Audit Committee Rule with that proposed in the Governance Disclosure Rule and Governance Policy. The Amendments provide that issuers that are income trusts should apply the Audit Committee Rule in a manner which recognizes that certain functions of a corporate issuer, its board and its management may be performed by any or all of the trustees, the board or management of a subsidiary of the trust, or the board, management or employees of a management company. For this purpose, references to “the issuer” refer to both the trust and any underlying entities, including the operating entity.

#### Authority for the Audit Committee Rule -- Ontario

In Ontario, securities legislation provides the Ontario Securities Commission (the OSC) with rule-making or regulation-making authority regarding the subject matter of the Audit Committee Rule.

Paragraph 143(1)57 of the *Securities Act* (Ontario) authorizes the OSC to make rules requiring reporting issuers to appoint audit committees and prescribing requirements relating to the functioning and responsibilities of audit committees, including requirements in respect of the composition of audit committees and the qualifications of audit committee members, including independence requirements.

#### Related Instruments

The Audit Committee Rule is related to National Instrument 51-102 *Continuous Disclosure Obligations*, National Instrument 71-102 *Continuous Disclosure and Other Exemptions Relating to Foreign Issuers*. The Amendments are related to the Governance Disclosure Rule and the Governance Policy.

#### Anticipated Costs and Benefits of the Audit Committee Rule and the Companion Policy

The anticipated costs and benefits of implementing the Audit Committee Rule and the Companion Policy were previously outlined in a paper entitled *Investor Confidence Initiatives: A Cost Benefit Analysis*, which was published on June 27, 2003. Given the nature of the Amendments, we did not consider it necessary to conduct a further cost benefit analysis.

#### Reliance on Unpublished Studies, Etc.

In developing the Amendments, we did not rely upon any significant unpublished study, report or other written materials.

#### Comments

Interested parties are invited to make written submissions on the Amendments. Submissions received by January 27, 2005 will be considered. **Because of timing concerns, comments received after the deadline will not be considered.**

## Request for Comments

---

Submissions should be addressed to:

Alberta Securities Commission  
Saskatchewan Financial Services Commission  
Manitoba Securities Commission  
Ontario Securities Commission  
Autorité des marchés financiers  
Nova Scotia Securities Commission  
New Brunswick 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

Please deliver your comments to the addresses below. Your comments will be distributed to the other participating CSA members.

John Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West  
Suite 1900, Box 55  
Toronto, Ontario M5H 3S8  
Fax: (416) 593-8145  
E-mail: [jstevenson@osc.gov.on.ca](mailto:jstevenson@osc.gov.on.ca)

Anne-Marie Beaudoin  
Directrice du secrétariat  
Autorité des marchés financiers  
Tour de la Bourse  
800, square Victoria  
C.P. 246, 22<sup>e</sup> étage  
Montréal (Québec) H4Z 1G3  
Fax: (514) 864-6381  
E-mail: [consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

A diskette containing the submissions (in Windows format, preferably Word) should also be submitted.

Comment letters submitted in response to requests for comments are placed on the public file and form part of the public record, unless confidentiality is requested. Comment letters will be circulated among the securities regulatory authorities, whether or not confidentiality is requested. Although comment letters requesting confidentiality will not be placed in the public file, freedom of information legislation may require securities regulatory authorities to make comment letters available. Persons submitting comment letters should therefore be aware that the press and members of the public may be able to obtain access to any comment letters.

Questions may be referred to the following people:

Rick Whiler  
Ontario Securities Commission  
Telephone: (416) 593-8127  
E-mail: [rwhiler@osc.gov.on.ca](mailto:rwhiler@osc.gov.on.ca)

Michael Brown  
Ontario Securities Commission  
Telephone: (416) 593-8266  
E-mail: [mbrown@osc.gov.on.ca](mailto:mbrown@osc.gov.on.ca)

Kari Horn  
Alberta Securities Commission  
Telephone: (403) 297-4698  
E-mail: [kari.horn@seccom.ab.ca](mailto:kari.horn@seccom.ab.ca)

## Request for Comments

---

Denise Hendrickson  
Alberta Securities Commission  
Telephone: (403) 297-2648  
E-mail: denise.hendrickson@seccom.ab.ca

Barbara Shourounis  
Saskatchewan Financial Services Commission  
Telephone: (306) 787-5842  
E-mail: bshourounis@sfsc.gov.sk.ca

Bob Bouchard  
Manitoba Securities Commission  
Telephone: (204) 945-2555  
E-mail: bbouchard@gov.mb.ca

Sylvie Anctil-Bavas  
Autorité des marchés financiers  
Telephone: (514) 395-0558 x. 2402  
E-mail: Sylvie.Anctil-Bavas@lautorite.qc.ca

### **Text of the Amendments**

The text of the Amendments follows.

October 29, 2004.