



January 25, 2018

British Columbia Securities Commission  
Alberta Securities Commission  
Financial and Consumer Affairs Authority of Saskatchewan  
The Manitoba Securities Commission  
Ontario Securities Commission  
Autorité des marchés financiers  
Financial and Consumer Services Commission of New Brunswick  
Superintendent of Securities, Prince Edward Island  
Nova Scotia Securities Commission  
Superintendent of Securities, Newfoundland and Labrador  
Superintendent of Securities, Yukon Territory  
Superintendent of Securities, Northwest Territories  
Superintendent of Securities, Nunavut

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Dear Sir/Madam:

Re: CSA Consultation Paper 52-404 *Approach to Director and Audit Committee Member Independence*

We have reviewed the CSA Consultation Paper 52-404 ("Consultation Paper") released October 26, 2017 and we thank the Canadian Securities Administrators ("CSA") for the opportunity to provide you with our comments.

CCGG's members are Canadian institutional investors that together manage over \$3 trillion in assets on behalf of pension funds, mutual fund unit holders, and other institutional and individual investors. CCGG promotes good governance practices in Canadian public companies in order to best align the interests of boards and management with those of their shareholders. We also seek to improve Canada's regulatory framework to strengthen the efficiency and effectiveness of the Canadian capital markets. A list of our members is attached to this submission.

## **Overview**

CCGG generally supports the CSA's current approach to determining director and audit committee member independence, namely, one that is largely subjective but contains prescriptive elements in the form of bright line tests that narrow the discretion that boards can bring to bear in determining independence. However, CCGG believes that this approach could be enhanced by supplementing the existing rules in relatively minor ways as outlined below.

The Consultation Paper highlights the concern expressed by some that the current approach should be changed because it unduly limits the pool of qualified candidates who can serve as independent directors or audit committee members. CCGG is unaware of any evidence to support the view that too few individuals are available to serve as directors. To respond to this unsupported criticism by allowing directors to determine that individuals with the relationships set out in the bright line tests are independent would be working at cross purposes with the CSA's initiative on another front to expand the pool of qualified candidates by including more women.

The Consultation Paper also points to the criticism that the current approach is inflexible and overly restrictive, resulting in suitable individuals being precluded from serving as independent directors. It is fair to say, however, that from the shareholders' perspective, historically the issue with board independence has been the opposite and the concept is applied too broadly: individuals are considered by boards to be independent even though relationships exist that might reasonably be expected to interfere with the exercise of independent judgment.

From this perspective, concerns arise that the bright line tests can be reflexively relied on by boards to overlook other important relationships that are not expressly captured in the tests but could reasonably be expected to interfere with the exercise of a member's independent judgment (e.g. strong social or educational connections). CCGG believes this concern could be ameliorated by making it clearer that the paramount principle underlying the independence test is the board's obligation to determine whether any relationships exist that could interfere with the exercise of independent judgement, along with an explicit statement to the effect that the board is not to assume that an individual who does not fall under one of the categories set out in the bright line tests necessarily can be considered independent.

Further, it would be appropriate to provide guidance by listing examples of additional relationships or considerations that could compromise independent judgment, such as strong social, educational or charitable connections. For instance, paragraph 3 of the commentary to Section 1.4 of National Instrument 81-107 *Independent Review Committee for Investment Funds* states that a "material relationship... may include an ownership, commercial, charitable,

industrial, banking, consulting, legal, accounting or familial relationship” and that “both past and current relationships” should be considered.<sup>1</sup> CCGG also suggests that the guidance include length of service on the board. CCGG does not believe that a bright line test stipulating that after a certain period of time, say ten years, a director can no longer be considered independent but rather that the CSA provide guidance that this is a factor boards should consider when assessing independence.

In effect, this would result in a hybrid between the rules in those jurisdictions that have bright line tests (Canada and the US) and those that use only guidance (e.g. UK, Australia, Sweden) and would retain benefits from both - the certainty and predictability provided by the bright line tests referred to in the Consultation Paper along with retaining the flexibility of board discretion and judgment.

We do not believe that the CSA should move towards the guidance only approach found in other jurisdictions such as the U.K., Australia and Sweden. The relationships set out in the bright line test comprise a very narrow group and are of such a nature that they should not present merely a rebuttable presumption that they compromise independence. Other relationships, however, are of a more nuanced nature so that whether they can reasonably be expected to compromise independence is more likely to depend on the fact-specific context. It is appropriate that guidance alone be provided for this second category.

### ***Consultation Questions***

1.

- a. *Do you consider our approach to determining directors and audit committee member independence appropriate for all issuers in the Canadian market? Please explain why or why not.*

The current CSA approach to determining director and audit committee member independence provides for different, less strict rules to apply to venture issuers than those that apply to non-venture issuers. CCGG believes that the stricter rules applicable to non-venture issuers should be extended to venture issuers as well. CCGG does not believe the non-venture issuer standards are onerous, CCGG believes that the importance of board and audit committee member independence to confidence in the public markets can not be overestimated and that with any access to the public markets should come the accountability of independent board oversight.

- b. *In your view, what are the benefits or limitations of our approach to determining independence? please explain*

CCGG believes the benefits to the CSA approach are those set out in the Consultation Paper: certainty, consistency and predictability. The CSA approach is also in line with the approach

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<sup>1</sup> NI 81-107, in the same commentary, also helpfully provides guidance for determining the independence of Independent Review Committee members by using phrases such as “may be independent”, “unlikely [to be] independent” and “rare [to be] independent” to precede indicia.

used in the U.S., making it straightforward both for interlisted issuers and for investors who invest in both the U.S. and Canadian markets and avoiding the complexity that would arise from different approaches when the markets are so closely integrated.

The limitations of the current CSA approach stem from its encouraging a tendency on the part of the board to avoid their responsibility to make an active determination of independence given all of the relevant circumstances and to simply default to the bright line tests. The clarification and guidance we suggest in the Overview would help to address this limitation.

- c. *Do you believe that our approach strikes an appropriate balance in terms of;*
  - i. *The restrictions it imposes on issuers' boards in exercising their discretion in making independence determinations, and*
  - ii. *The certainty it provides boards in making those determinations and the consistency and predictability it provides other stakeholders in evaluating the independence of an issuers' directors or audit committee members?*

While CCGG believes that the CSA's general approach strikes an appropriate balance, we recommend the adoption of the changes outlined in the Overview above so that more guidance is provided about (i) the key principle underlying the approach and (ii) examples of additional relationships for boards to consider when fulfilling this principle. We believe these changes would strengthen this approach.

- d. *Do you have any other comments regarding our approach?*

Please see the Overview discussion above.

- 2. *Should we consider making any changes to our approach to determining independence as prescribed in NI 52-11, such as changes to:*
  - a. *The definition of independence;*
  - b. *The bright line test for directors and audit committee members: or*
  - c. *The exemptions to the requirement that every audit committee member be independent?**Are there other changes we should consider? Please explain.*

CCGG does not believe that changes should be made to a., b., or c. above. However, CCGG believes that guidance should be added to the definition of "material relationship" in section 1.4(2) of NI 52-110 to assist directors in determining which sort of relationships may reasonably be expected to interfere with the exercise of a member's independent judgment by providing examples of the sorts of indicia that may be relevant as outlined in the above Overview. Further, there should be clarification that the responsibility of the board to determine what can reasonably be expected to interfere with the exercise of independent judgment is the key animating principle of the CSA approach to determining independence and the board is not to rely on the enumerated list of those individuals that are not independent in order to determine that everyone else can be presumed to be independent.

We also caution against following any suggestions from commentators to amend NI 52-110 1.4(3)(f) to increase the \$75,000 threshold therein on the basis that this level is unrealistically low and that it will preclude individuals from serving on audit committees in situations where this amount of money can not reasonably be expected to interfere with independent judgment,

thereby unnecessarily limiting the pool of available independent directors. Section 1.5(1)(a) stipulates that 'any' consulting, advisory or other compensation fee (apart from board or committee remuneration) will preclude an individual from sitting on the audit committee as an independent, and thus even amounts less than \$75,000 may imply a material relationship. The suggestion would also reflect an assumption that board candidates all share a certain economic background whereby \$75,000 is an insignificant amount of money which, again, does not recognize that individuals other than the historically typical board member may be appropriate candidates for the board (e.g. academics). Accordingly, we believe it is appropriate to keep the current limit.

3. *What are the advantages and disadvantages of maintaining our approach to determining independence versus replacing it with an alternative approach? Please explain.*

See the answer to question 1(b) above. Changing the approach to determining independence could replace predictability, certainty, consistency and familiarity, with confusion. It would also mean that Canadian rules would be out of step with those in place in the U.S., which would result in added complexity both for interlisted issuers and for investors generally.

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We thank you again for the opportunity to provide you with our comments. If you have any questions regarding the above, please feel free to contact our Executive Director, Stephen Erlichman, at 416.847.0524 or [serlichman@ccgg.ca](mailto:serlichman@ccgg.ca) or our Director of Policy Development, Catherine McCall at 416.868.3582 or [cmccall@ccgg.ca](mailto:cmccall@ccgg.ca).

Yours very truly,



Julie Cays, CFA  
Chair of the Board  
Canadian Coalition for Good Governance

## CCGG Members – January 2018

Alberta Investment Management Corporation (AIMCo)

Alberta Teachers' Retirement Fund (ATRF)

Archdiocese of Toronto

BlackRock Asset Management Canada Limited

BMO Asset Management Inc.

British Columbia Investment Management Corporation (bcIMC)

Burgundy Asset Management Ltd.

Caisse de dépôt et placement du Québec

Canada Pension Plan Investment Board (CPPIB)

Canada Post Corporation Registered Pension Plan

CIBC Asset Management Inc.

Colleges of Applied Arts and Technology Pension Plan (CAAT)

Connor, Clark & Lunn Investment Management Ltd.

Desjardins Global Asset Management

Electrical Safety Authority (ESA)

Fiera Capital Corporation

Franklin Templeton Investments Corp.

Greystone Managed Investments Inc.

Healthcare of Ontario Pension Plan (HOOPP)

Hillsdale Investment Management Inc.

Industrial Alliance Investment Management Inc.

Jarislowsky Fraser Limited

Leith Wheeler Investment Counsel

Lincluden Investment Management Limited

Mackenzie Financial Corporation

Manulife Asset Management Limited

NAV Canada  
Northwest & Ethical Investments L.P. (NEI Investments)  
OceanRock Investments Inc.  
Ontario Municipal Employee Retirement System (OMERS)  
Ontario Pension Board  
Ontario Teachers' Pension Plan (OTPP)  
OPSEU Pension Trust  
PCJ Investment Counsel Ltd.  
Pension Plan of the United Church of Canada  
Pier 21 Asset Management Inc.  
Public Sector Pension Investment Board (PSP Investments)  
RBC Global Asset Management Inc.  
Régimes de retraite de la Société de transport de Montréal (STM)  
Scotia Global Asset Management  
Sionna Investment Managers Inc.  
State Street Global Advisors, Ltd. (SSgA)  
Sun Life Investment Management Inc. (SLIM)  
TD Asset Management Inc.  
Teachers' Retirement Allowances Fund  
UBC Investment Management Trust Inc.  
University of Toronto Asset Management Corporation  
Vestcor Investment Management Corporation  
Workers' Compensation Board - Alberta  
York University

