Canadian Coalition for
GOOD GOVERNANCE

THE VOICE OF THE SHAREHOLDER

August 19, 2014

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority (Saskatchewan)
Manitoba Securities Commission
Ontario Securities Commission
Autorite des marches financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

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Dear Sir/Madam:

Re: CSA Notice and Request for Comment to
National Instrument 51-102 *Continuous Disclosure Obligations*
National Instrument 41-101 *General Prospectus Requirements* and
National Instrument *52-110 Audit Committees* (the "Request for Comment" or the "Proposed Amendments")

We have reviewed the Request for Comment released May 22, 2014 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 $2.5 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.

In this comment letter we respond only to the corporate governance issues raised by the Request for Comment that are relevant to our members.

Overview

Listing on an exchange in Canada is a privilege and not a right: there must be appropriate protections for investors in those companies that have the imprimatur bestowed by a listing. As we commented previously on prior proposals to streamline venture issuer regulation,[1] we continue to believe that the Proposed Amendments overall will result in less protection for investors and have the potential to adversely affect the reputation of the Canadian capital markets among international investors. In our view, smaller companies are not in less need of robust governance practices and the risk to investors of the lack thereof does not diminish with the smaller size of the company. The existing regime already recognizes some of the unique aspects of venture issuers through less stringent governance disclosure requirements for them. The Proposed Amendments also eliminate information that is valuable to investors. The adoption of the Proposed Amendments also may have the unintended consequence of incentivizing issuers to list on the TSX-V rather than the TSX solely for the purpose of limiting their disclosure and governance obligations.

Quarterly Reporting

We are pleased that the Proposed Amendments continue to have quarterly reporting obligations for venture issuers and do not disagree with the proposal that venture issuers without significant revenue be able to file streamlined 'quarterly highlights" in each of the first three quarters. We believe that the quarterly highlights should be certified by management.

We do not think that venture issuers with significant revenue should be permitted to provide quarterly highlights disclosure.

Increased Significant Acquisition Threshold and Reduced Business Acquisition Reporting

The Proposed Amendments would increase the level at which an acquisition will be considered "significant", and thus require a venture issuer to file a Business Acquisition Report ("BAR"), from 40% to 100%. CCGG believes that increasing the threshold is inappropriate and that acquisitions in the 40% to 100% range are by nature significant. Information about such acquisitions should be publicly disclosed to shareholders with the amount of detail, including the financial information, required in a Form 51-102F4 BAR.

In addition, we disagree with the proposal to eliminate the requirement that BARs filed by venture issuers must include pro forma financial statements.

Further, CCGG is concerned with the issue that the Request for Comment highlights: namely, if the proceeds of a prospectus offering will be used to finance a proposed acquisition in the 40% to 100% range,

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[1] CCGG's three earlier comment letters can be found at:
http://www.ccgg.ca/site/ccgg/assets/pdf/CSA_Multilateral_Consultation_Paper.pdf;
hnp://www.ccgg.ca/site/ccgg/assetsfpdf/Submission_to_CSA_re_Proposed_National_Instrument_51-103_Venture_Issuers_signed.pdf;
http://www.ccgg.ca/site/ccgg/assets/pdf/submission_to_csa_re_venture_issuer_regulation.pdf

there will be no specific requirement in the Proposed Amendments to include any disclosure about the proposed acquisition in the prospectus. The prospectus would still be subject to the requirement to provide full, true and plain disclosure of all material facts relating to the securities to be distributed but, as the Request for Comment points out, if financial statements of the business being acquired are not viewed as necessary to meet the full, true and plain disclosure standard, there may be no financial statements related to the business to be acquired in the prospectus.

In answer to question 3 posed in the Request for Comment, i.e. "do you think that a prospectus should always include BAR-level discourse about a proposed acquisition if it is significant in the 40% to 100% range and any proceeds of the prospectus offering will be used to finance the proposed acquisition?", CCGG is of the view that it should always be included. Because CCGG does not believe that the BAR threshold should be raised from 40% to 100%, however, we believe the problem is better avoided by retaining the current 40% threshold.

On the same basis, CCGG would answer the following questions posed in the Request for Comment in the affirmative:

4. "Do you think that an information circular should always include BAR-level disclosure about a proposed acquisition if it is significant in the 40% to 100% range, and the matter to be voted on is the proposed acquisition?" and
5. "Do you think we should require BAR-level disclosure in a prospectus where financing has been provided (by a vendor or third party) in respect of a recently complete acquisition significant in the 40% to 100% range and any proceeds of the offering are allocated to the repayment of the financing?"

In response to question 6 in the Request for Comment as to whether it would be a problem if the significance threshold for prospectus and information circular disclosure are not harmonized with the threshold for continuous disclosure, which will occur if the Proposed Amendments are adopted, CCGG is of the view that there will be a logical inconsistency in the two disclosure regimes - the appropriate response is to not change the threshold in the continuous disclosure regime from 40% to 100%.

In response to question 7 in the Request for Comment, we do not believe that investors will be able to make a sufficiently informed investment or voting decision if BAR-level disclosure is not required in the prospectus and information circular situations referred to above.

Reduced Compensation Disclosure

We continue to maintain that all public companies should be providing the same level of executive compensation disclosure. We do not believe that the disclosure required under the current regime is a significant burden for issuers. Nor do we believe that what is proposed in the Request for Comment will in fact reduce the burden on venture issuers in any meaningful way, but at the same time it will keep important information from shareholders. The information revealed by comprehensive executive compensation disclosure goes beyond merely the amounts disclosed: it enables shareholders to gather information about whether a board is properly carrying out its stewardship role of overseeing management and ensuring that executive pay is aligned with company performance. Executive compensation may be the most tangible manifestation that shareholders have of how effectively this role is being carried out.

In particular, we believe that combining NEO and director compensation information into one table reduces the clarity and utility ofthat disclosure, while doing nothing to lessen the burden on venture issuers. It is implausible to suggest that separating the same information into two tables is more onerous than placing the same information in one table. It also has the effect of implying that the roles of management and directors, and the way they should be compensated for those roles, are similar, which is incorrect. We

believe it is especially important to be clear on the differences between these roles in the case of venture issuers since they are more likely to have related parties in executive and director roles. The Proposed Amendments also appear to contemplate aggregating the compensation for two different roles (e.g. CEO and director) into one figure within the table. We suggest that it should be very clear whether the CEO, for example, is receiving options in his or her capacity as CEO or as a director. To do otherwise would seem to defeat the purpose of the disclosure.

Further, we understand that one of the goals of the CSA in adopting the use of a Summary Compensation Table in 2008 was to provide shareholders with one aggregate number that would tell them what directors intended to pay each named executive officer in a particular year. By removing information about compensation securities from the Summary Compensation Table, and placing it in a separate Compensation Securities Table which does not require valuations, this goal is frustrated. The information is just as relevant to investors in venture issuers as it is for investors in other public companies.

While CCGG supports the proposal to allow stock options or other securities-based compensation to be disclosed at fair market value at the time options are exercised, we do not support the elimination of the current requirement to disclose the grant date fair value of stock options. What the board intends to pay an executive at the time the award is made is valuable information for shareholders and, in conjunction with the disclosure of fair market value at the time of exercise, allows shareholders to compare how the actual return to an executive compares with the board's intentions. Further, since options may comprise a large portion, if not all, of variable pay at venture issuers, a requirement that grant date fair values be disclosed will ensure that directors of these issuers consider the measure of wealth transfer from shareholders to executives when granting options and be in a position to justify to shareholders that the value is warranted. In any case, options should not be granted without an understanding of the value of those options. We question the monetary savings that the CSA states would be realized by venture issuers with the elimination of the need to have a valuation undertaken for options awarded since this must be done annually for accounting purposes in any event.

We note that under section 2.3 (3)(a) of proposed Form 51-102F6V, the Compensation Securities Table must be accompanied by a note that discloses "the total amount of compensation securities, and underlying securities, held by each named executive officer or director" but that it is not clear whether "amount" refers to number or value of securities held. CCGG believes both should be disclosed.

We do not support reducing the number of "named executive officers" for which compensation disclosure is required from five to three. If an executive meets the prescribed threshold (total compensation of more than $150,000) there is no reason to assume information about his or her compensation would not be material to shareholders assessing a venture issuer's compensation program. The additional burden on venture issuers would be minimal.

Similarly, we do not support permitting venture issuers to provide only two years of compensation information instead of three. Typically, executive compensation programs incorporate elements that are designed to reward performance over a time frame of greater than two years, especially when securities-based awards are part of the program. A two year picture does not provide enough information about the alignment of compensation and company performance to enable shareholders to meaningfully assess the link.

In summary, the proposed changes to compensation disclosure will be a step backwards in the progress that has been made since new executive compensation disclosure rules were adopted in 2008 and 2011 in order to make compensation decisions and their rationale clearer for the owners of public companies. In the end, owners of venture issuers, which comprise the majority of Canadian public companies, will have

significantly less meaningful executive compensation information than non-venture owners and CCGG believes this is not a positive step for the capital markets and cannot be justified on a cost/benefit analysis. While the proposal to replace interim MD&As with quarterly financials for venture issuers without significant revenue will no doubt reduce the time and cost burden on venture issuers while continuing to provide necessary information to investors, the same will not be true of the proposed executive compensation disclosure. We question the statement that investors will benefit because the disclosure would be more "concise, salient and easier to understand". While the disclosure may be more concise it will not be more salient or easier to understand and in fact will prove the opposite: investors will not have all the information they need to make a meaningful assessment of executive compensation decisions.

Composition of Audit Committee

We support the CSA's move to introduce a mandatory independence standard to the composition of audit committees of venture issuers, which are currently exempt from the independence requirements of National Instrument 52-110 *Audit Committees*.[2] We suggest, however, that the CSA should go further and introduce a more stringent independence requirement, as well as an expectation of financial literacy, for members of venture issuer audit committees.

The proposed amendments would require that for venture issuers:

- Audit committees be composed of at least three members, and
- A majority of the members of the audit committee must not be executive officers, employees or control persons of the venture issuer or of an affiliate of the venture issuer

The first requirement is the same as for non-venture issuers. The second, however, falls short of the non-venture requirements in two ways: (i) only a majority of the members must reflect the specified standard of independence whereas for non-venture issuers all of the audit committee members must be independent and (ii) the standard of independence required is not as stringent. CCGG believes that both of these shortcomings should be remedied.

It is CCGG's view that the audit committees of all public companies should be wholly independent, given the unique importance of the audit committee role in protecting the investors' interests. The proposed independence requirements for venture issuers would permit legal and other advisors, consultants and family members of executive officers or employees to sit on the audit committee and we do not believe this is any more appropriate for smaller public companies than it is for larger more established ones. At the very least, CCGG suggests that if CCGG's views are not accepted and thus the less stringent standard of independence is retained, then all of the members of the audit committee must meet that standard and not just a majority. Further, the chair of the audit committee should be independent.

Similarly, while all of the members of a non-venture issuer's audit committee must be financially literate, there are no financial literacy requirements for audit committees of venture issuers. Given that the applicable definition of 'financially literate' is not demanding[3], CCGG believes that this minimum level of expertise and understanding should be required of the audit committee members of venture issuers.

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[2] Section 6.1 of National Instrument 52-110 *Audit Committees*. We noted in an earlier submission to the CSA on venture issuer regulation, however, that venture issuers were already subject to audit committee independence standards by virtue of the CBCA, OBCA and the TSX-V listing requirements.

[3] Companion Policy 52-110CP *to National Instrument 52-110 Audit Committees, Part 4, Financial Literacy, Financial Education and Experience:* "an individual is financially literate if he or she has the ability to read and understand a set of financial statements that present a breadth and level of complexity that are generally comparable to the issues that can reasonably be expected to be raised by the issuer's financial statements".

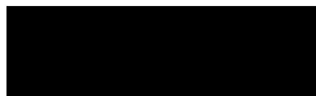
In response to question 8 posed in the Request for Comment, if the Proposed Amendments with respect to audit committee independence are adopted we do not believe that exemptions similar to those found in sections 3.2 to 3.9 of NI 52-110 should be provided.

Conclusion

In summary, we continue to believe that the potential negative consequences of reducing the governance and executive compensation disclosure requirements outweigh the possible benefits to venture issuers of further streamlining and simplifying their compliance. Given that the majority ofthe publicly listed companies in Canada are TSX V-issuers, with these proposals the CSA risks creating the perception among international investors that Canada's governance standards as a whole are lax. It also may create an incentive for issuers to list (or continue to be listed) on the *TSX-V* even if they are eligible to be listed on the TSX, simply to avoid the TSX's more stringent governance and disclosure regime.

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 or our Director of Policy Development, Catherine McCall at 416.868.3582 or cmccall@ccgg.ca.

Yours very truly,



Daniel E. Chornous, CFA
Chair of the Board
Canadian Coalition for Good Governance

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