



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

We are writing in response to the request for comments on the Canadian Securities Administrators' (CSA) *Consultation Paper 52-404 – Approach to Director and Audit Committee Member Independence*.<sup>1</sup>

With approximately C\$6 billion in assets under management, NEI Investments' approach to investing incorporates the thesis that companies can mitigate risk and take advantage of emerging business opportunities by integrating best environmental, social and governance (ESG) practices into their strategies and operations.

In addition to submitting the comments below, we would like to draw attention to the submission by the Canadian Coalition for Good Governance (CCGG), of which NEI Investments is a member.

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<sup>1</sup> [http://osc.gov.on.ca/en/SecuritiesLaw\\_csa\\_sn\\_20171026\\_52-404\\_committee-member-independence.htm](http://osc.gov.on.ca/en/SecuritiesLaw_csa_sn_20171026_52-404_committee-member-independence.htm)



## Advancing board independence and diversity

Our view of the duty of a public company board is grounded in the stakeholder theory of the firm, which holds that the purpose of the company is to create value for all its stakeholders, including shareholders.<sup>2</sup> We believe that, to fulfil its duty effectively, the board of a public company must be diverse in identity and expertise, and consist predominantly of well-qualified independent directors who do not depend on the company for any benefit or consideration beyond reasonable remuneration for their board work. Our proxy voting guidelines include provisions to withhold our vote from non-independent director candidates when the board is less than two-thirds independent or if they serve on key board committees, and from nominating committee members if the board lacks diversity.<sup>3</sup>

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According to the consultation paper, some stakeholders have expressed concern that the current approach to determining independence has prevented candidates with expertise and sound judgement from being considered independent or serving as audit committee members, or has limited the pool of potential independent directors. However, no evidence is offered to support these contentions. Against a background of slow progress in increasing the representation of women on Canadian public company boards, and at a time when boards need to develop capacity to provide oversight for a range of emerging issues, from climate risk to cybersecurity, we believe the priority should be expanding the pool of directors with new, diverse candidates who contribute expertise in new areas. We counsel against independence criteria changes that could undermine the valuable work securities regulators have undertaken in recent years on board diversity, by allowing or encouraging public companies to retreat into traditional networks of contacts in recruiting directors. We question whether all companies are making sufficient efforts at present to expand the reach of their director recruitment efforts, noting that many boards have yet to recruit their first female director, even though some of our largest and most successful companies have been able to find multiple well-qualified women candidates.

Although we offer responses to the consultation questions below, we do not believe that relaxation of the director independence requirements should be a policy priority for the CSA at this time. We would prefer to see further efforts to promote board diversity.

## Responses to consultation questions

**1. Our approach to determining director and audit committee member independence is described in section 3.2 of this Consultation Paper.**

- a. Do you consider our approach appropriate for all issuers in the Canadian market? Please explain why or why not.
- b. In your view, what are the benefits or limitations of our approach to determining independence? Please explain.
- 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 issuer's directors or audit committee members?
- d. Do you have any other comments regarding our approach?

<sup>2</sup> More information can be found in our Responsible Investment Policy: <https://www.neiinvestments.com/documents/Marketing/RI%20Policy.pdf>

<sup>3</sup> More information can be found in our Proxy Voting Guidelines: <https://www.neiinvestments.com/documents/FlippingBooks/Proxy%20Voting%20Guidelines%202016/index.html>

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Shareholders have the important role of voting on the directors who will provide oversight of the company for the benefit of all stakeholders. We are rarely in a position to assess the actual independent-mindedness of directors as they operate within the boardroom, so in our proxy voting practice our decisions on director independence are based on various tests that explore a candidate's relationship to the company and to other directors. The bright-line tests in the requirements simplify the task of assessing independence. Less consistency in the way companies interpret director independence across the Canadian market would be problematic for many institutional investors, as we must make a vote decision on each director at each company in our holdings under considerable time pressure during proxy season. Our likely response to removal of the bright-line tests from the requirements would be to ask our proxy voting advisors, who undertake research to support our proxy voting, to apply bright-line tests in that research. If changes in the requirements encouraged greater deviation from established independence norms, this could lead to an increased number of withheld director votes.

**2. Should we consider making any changes to our approach to determining independence as prescribed in NI 52-110, such as changes to: a. the definition of independence; b. the bright line tests 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.**

Although we see no need to change the approach at this time, the CSA could consider augmenting it with additional guidance addressing the impact of tenure on independence. We note that in certain markets, assessment of director independence already includes consideration of director tenure. At present we do not include a provision in our proxy voting guidelines that would lead us to consider directors non-independent after a certain number of years of tenure, but we are giving increasing attention to this issue. As well as creating independence concerns, long tenure can be an obstacle to enhancing diversity, for it is hard to recruit new, diverse directors to a board if there are no vacant board seats.

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

We do not see any major disadvantage in maintaining the current approach, since no evidence was put forward either to support the contention that the current approach is preventing boards from recruiting qualified directors, or to demonstrate that the potential for financial reporting or other corporate governance scandals has diminished in a way that makes board independence a lesser concern than in the past. As we noted above, an advantage of the current approach is consistency in the way companies interpret director independence across the Canadian market, which is beneficial to the institutional investors voting on director elections at Canadian companies in their holdings. In our view, a key disadvantage in replacing the current approach would be challenges for companies inter-listed in both the U.S. and Canada.

## Conclusion

We appreciate the opportunity to offer our perspective on the consultation paper. We do not believe that relaxation of the director independence requirements should be a policy priority for the CSA at this time, and would prefer to see effort directed to the promotion of board diversity, and potentially to exploration of the

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implications of excessive board tenure. Please do not hesitate to contact me if you have any questions in relation to this submission.

Sincerely,  
**NEI Investments**



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cc:  
Board of Director, NEI Investments  
Responsible Investment Executive Committee, NEI Investments  
Rosa van den Beemt, Senior ESG Analyst, NEI Investments

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