

**BY EMAIL**

February 8, 2018

British Columbia Securities Commission  
Alberta Securities Commission  
Saskatchewan Financial Services  
Commission  
Manitoba Securities Commission  
Ontario Securities Commission  
Autorité des marchés financiers  
New Brunswick Securities Commission

Registrar of Securities, Prince Edward Island  
Nova Scotia Securities Commission  
Superintendent of Securities, Newfoundland  
and Labrador  
Superintendent of Securities, Northwest  
Territories  
Superintendent of Securities, Yukon  
Superintendent of Securities, Nunavut

C/O:

Me Anne-Marie Beaudoin  
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Dear Sir/Madam:

**RE:** Canadian Securities Administrators Consultation Paper 52-404 – Approach to Director and Audit Committee Member Independence (the **Consultation Paper**)

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This submission is made by the Public Sector Pension Investment Board (“PSP Investments”) in response to the Consultation Paper released on October 26, 2017.

By way of background, PSP Investments is one of Canada’s largest pension investment managers, with \$139.2 billion of net assets under management as at September 30, 2017. We invest funds for the pension plans of the Public Service, the Canadian Armed Forces, the Royal Canadian Mounted Police and the Reserve Force. Our skilled and dedicated team of more than 700 professionals manages a diversified global portfolio composed of investments in public financial markets, private equity, real estate, infrastructure, natural resources and private debt. Our business offices are in Montréal, New York, and London. Our head office is in Ottawa.

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## **General Comments**

We are pleased to have the opportunity to comment on the issues raised in the Consultation Paper.

As a long-term institutional investor in the global equity markets, we believe that corporate governance practices, meaningful disclosure and responsible corporate behaviour contribute to the long-term performance of the listed companies in which we invest and are important to well-functioning public capital markets.

In particular, we believe that well-sized and diverse boards with the proper balance of skills, expertise and independence are critical to a company's long-term success. We therefore place considerable importance on the quality of the directors as well as the overall composition of boards. We believe that high performing and effective boards are the result of a robust nominating process that will attract qualified and independent candidates from diverse backgrounds and that independent board leadership is a key element of effective boards. We further believe that a board should be constituted by a majority of independent directors to ensure that it can operate independently of management. We consider that directors who are in a position to exercise objective judgment, free of any external influence, are best positioned to successfully supervise a company to support the creation of long-term shareholder value.

Key committees such as the audit, compensation and nomination committees should generally consist of at least three members, all of whom independent directors. In particular, we expect audit committees to be solely comprised of directors that are independent and unrelated to a controlling shareholder.

External auditors play an important role in verifying the integrity of a company's financial reporting to ensure that information ultimately provided to shareholders is free from material misstatements and presented fairly in all material respects. As such, we place great importance on the quality and independence of the external auditors. As auditor appointments should be recommended by an audit committee of the board of directors, it is important that audit committee members be free from conflicts of interest with the external auditors.

## **Responses to Specific 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.*

We believe that the current approach to determine director and audit committee member independence is appropriate as it strikes the proper balance between bright

line tests and subjective tests, based on the appreciation of the board of certain material relationships. However, we question the rationale of having less stringent requirements for issuers listed on the TSX Venture Exchange as independent oversight of management and the financial reporting functions are fundamental corporate governance practices that contribute to vibrant capital markets.

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

The greatest benefit of the current approach to determining independence is that the bright line tests provide a common base line for all Canadian reporting issuers. These tests set a minimum standard by which independence is determined, allowing shareholders and other market participants to easily and reliably assess the level of independence at the board level as well as compliance in respect to the independence of audit committee members.

Furthermore, the current approach provides a common language to foster efficient dialogues between issuers and shareholders in respect to director independence and board composition. It also facilitates consistent and rigorous voting decisions as the level of independence in respect to board composition and for audit committees is a key element considered in proxy voting activities.

Finally, as the duties performed by the audit committee are key to support and foster the integrity of the market, the requirement that audit committee should be comprised of independent directors, together with the basis on which these determinations are made are appropriate.

In terms of limitations, we acknowledge that the flip side of having bright line tests and common base line to assess the independence of directors is the reduced level of discretion and flexibility afforded to boards in assessing independence. On the other hand, there may also be an over reliance on the bright line tests and boards may fail to appropriately consider other material relationships that may compromise independence.

On balance, we believe that the benefits of the current approach offset the limitations.

- c) Do you believe that our approach strikes an appropriate balance in terms of:*
- o the restrictions it imposes on issuers' boards in exercising their discretion in making independence determinations, and*

- *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?*

Yes. We believe that the current approach strikes the appropriate balance in terms of the restrictions placed on boards in exercising its discretion in making independence determinations and the consistency and predictability it provides shareholders and other stakeholders in that respect.

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

We note that the current approach is consistent and aligned with that of the United States. Given the high degree of integration of financial markets between the United States and Canada evidenced, in part, by the number of issuers listed in both countries, we believe it is preferable that both jurisdictions maintain a consistent approach in defining independence.

While we appreciate that that some issuers may forego qualified candidates due to the prescriptive aspects of the current framework, we note that this can be overcome by a robust nomination process that should extend beyond individuals that have pre-existing material relationships with issuers. A notable development since the adoption of the current approach in 2004, is the accessibility of director education programs that have formed many cohorts of capable, qualified and diverse directors that can be tapped into for board and audit committee service.

As an institutional shareholder, PSP Investments values the consistency and predictability of the current approach. In the absence of bright line tests, we would be left to confirm director independence with limited or imperfect information. This information asymmetry may lead to inefficient capital markets.

We could struggle to understand the determinations made by boards in respect to independence if such determinations were solely left to subjective tests, based on the appreciation of the board of certain material relationships. Under such a framework, we would have to frequently engage with boards to either understand or challenge their determinations. The lack of visibility of the factors considered to support the assessment of independence by boards could lead to an increased number of votes against or withheld for reelection of directors.

The CSA should also consider providing additional guidance in respect to the definition of "material relationships" in two meaningful ways. First, tenure should be a specific factor that is considered by boards when assessing whether a material relationship could compromise the independence of directors. Several jurisdictions, such as the

United Kingdom, France and Australia, have adopted guidelines whereby the length of tenure (nine to twelve years, depending on the market) is a specific factor that compromises independence. We also note that several institutional shareholders, including PSP Investments, have adopted proxy voting guidelines that take into account the length of tenure when determining the independence of directors. Second, the CSA should further emphasize the overall principle of independence and the obligations of the board to assess the materiality of all relationships between a director and an issuer when making determinations in respect to independence. To that end, it may be helpful to provide additional guidance in respect to relationships that could be considered material, such as how to consider social and past relationships.

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;*

We find that the definition of independence is appropriate. However, as noted above, we believe that boards would benefit from additional guidance to in respect to the assessment of the materiality of certain relationships that are not caught by bright line tests.

b) *the bright line tests for directors and audit committee members; or*

We find that the bright line tests for directors and audit committee members are appropriate. We are not aware of any empirical evidence to the effect that these bright line tests have hampered the recruitment of independent and qualified directors to serve as audit committee members. Accordingly, we do not believe that these bight line tests need to be changed..

c) *the exemptions to the requirement that every audit committee member be independent?*

We believe that current exemptions to the requirement that every audit committee member be independent are appropriate.

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

There are many benefits of maintaining the current approach such as it: i) is well understood by market participants; ii) provides, in a transparent fashion, crucial information in respect to the independent oversight of management and the financial reporting function; and iii) fosters the adoption of the best practices of having a majority of independent directors and an independent chair or lead director.

On the other hand, we acknowledge that these benefits come at the price of reduced board discretion to assess the materiality of certain relationships when determining independence. However, one should be mindful that any approach has its advantages and disadvantages. We therefore believe that the adoption an alternative approach in respect to director independence needs to be supported by clear incremental benefits to the Canadian corporate governance regime. We do not believe that providing board with the ability to determine independence with subjective tests, solely based on its appreciation of certain material relationships will positively impact corporate governance practices as whole. Accordingly, we respectfully submit that the current approach be maintained, subject to: i) the additional guidance in respect to how to assess the materiality of certain relationships; and ii) the same requirements applying to all Canadian, whether listed on the TSX Venture Exchange or the Toronto Stock Exchange.

Thank you again for providing the opportunity to share on views the Consultation Paper. Director independence is a very important issue, a cornerstone of the corporate governance regime in Canada.

Should you require any additional information in respect to this comment letter, please feel free to contact the undersigned.

Best regards,



Stéphanie Lachance  
Vice President, Responsible Investment