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Via email:
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Dear members of the Canadian Securities Administrators (CSA),

RE: CSA Consultation Paper 52-404, Approach to Director and Audit Committee Member Independence

Chartered Professional Accountants of Canada (CPA Canada) applauds the CSA's ongoing commitment to review and proactively consider making changes to the current director independence regime. We welcome this consultation process and are pleased to provide general comments as well as responses to the three specific questions outlined in your consultation paper.

About CPA Canada

CPA Canada is the national organization which represents Canada's accounting profession, with more than 210,000 members at home and abroad. The Canadian CPA designation was created through the unification of three legacy accounting designations (CA, CGA, and CMA). CPA Canada conducts research into current and emerging business issues and supports the setting of accounting, auditing, and assurance standards for business, not-for-profit organizations, and government. CPA Canada also issues guidance and thought leadership on a variety of technical matters, publishes professional literature, and develops education and professional certification programs.

General Comments on Independence: Tightly-Held versus Widely-Held

As part of the CSA's broader mandate for this consultation, CPA Canada would like to offer the following thoughts for consideration.

Independent directors play an important role in the stewardship of the corporation, and are expected to serve as an added layer of protection against any opportunistic influences of management or controlling shareholders.

This mandate can be challenging, due to the fact that independent directors are effectively appointed by controlling shareholders, or those with significant influence. This can lead to situations in which an independent director may feel pressure to put the interests of the controlling shareholder ahead of the corporation.

The risk of such an occurrence can be most acute in Canadian issuers that are tightly-held, or have dual-class share structures.¹ In light of this, CPA Canada encourages the CSA to consider measures to address concerns relating to dual-class share structures and tightly-held corporations by enhancing the independence of these directors.

We also appreciate that during the 2008 comment period on governance changes, a number of companies and institutional investors in Canada supported revisions to National Instrument (NI) 52-110 that would allow directors with material relationships with an issuer's controlling shareholder, to be considered independent, as long as the individual was otherwise independent of the issuer's management.²

This appears contradictory to our position above, which requests greater independence between a director and the controlling shareholder. However, we can appreciate that there are examples where both situations could be beneficial.

For example, in tightly-held companies, the risk of the controlling shareholder acting opportunistically is likely greater than management's ability to do so. In such a case, the notion of enhancing director independence can be valuable.

However, in the case of a more widely-held company, there may be a greater risk that management, rather than any one shareholder may attempt to usurp the decision making process. In these situations, directors who have a relationship with an issuer's larger shareholders (but are otherwise independent of management) could be considered independent, and revisions to NI 52-110 may address this possibility.

Therefore, the CSA should consider creating a new framework that would enhance director independence for tightly-held and dual-class issuers, while fine-tuning the nuances of the current independence regime as it relates to widely-held issuers.

¹ Canadian Coalition for Good Governance Publication, "Dual Class Share Policy," September 2013.

² M. Merkley, L. Churchill, "Are Directors Independent? It Depends: CSA Revisiting Regime" Blakes LLP, November 15, 2017.

Specific Responses

Please find below, our responses to the three questions specifically posed in your consultation paper:

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.

As outlined in our general comments section, the CSA may want to explore alternative approaches to director independence, based on whether the issuer is tightly-held, has a dual-class share structure, or is widely-held.

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

As outlined in your consultation paper, certainty, consistency and predictability are key benefits to maintaining the current approach to independence. The limitation, however, relates primarily to the possibility of failing to attract otherwise qualified individuals, who are precluded from being a director due to the inflexibility of existing parameters. We expand upon these features in our response to your third question, below.

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?

The current approach is well suited to provide certainty to boards, while also maintaining appropriate restrictions on who is able to serve as an independent director. As with all rules, however, it is important to reconsider from time to time if a change could strengthen board governance. In addition to the few suggestions that we have raised for your consideration in our response, we trust others will also be able to provide different viewpoints, which will bring their own benefits and drawbacks that the CSA will need to weigh.

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

Independence in Canada should always be held to the highest standard possible. As such, our view is that a rules-based approach, that is at least as strict as the U.S. Securities and Exchange Commission's rules, is appropriate.

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;

As noted in our general comments, a change to the definition of independence which could differentiate between directors who are independent of both management and controlling shareholders, and those who may have a relationship with a large or controlling shareholder, but are independent of management, could be useful. In the right circumstances, it may increase the pool from which directors could be identified, while not degrading the quality or perceived quality of work from the director.

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

The bright line tests are beneficial in that they continue to assist inter-listed issuers in Canada and the U.S. find, with certainty, directors who are classified as independent in both jurisdictions. This certainty is valuable to this group of issuers, as such, we are not suggesting any changes.

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

CPA Canada recognizes the importance of having each member of the audit committee be independent. However, we also understand that circumstances can arise in which valid exceptions to a requirement can be legitimately made. In such instances, the exception must be reasonable, it should have appropriate safeguards in place, and whenever possible, the exception should be temporary.

In our view, the exemptions to the requirement outlined in NI 52-110 subsection 3.1(3), meet the above criteria. For example, the CSA has identified a specific list of reasonable exceptions and, for the avoidance of doubt, has clearly outlined them in sections 3.2 – 3.6. Furthermore, they are each subject to qualifiers, and many of them have specific safeguards in place that trigger an additional layer of oversight, such as sections 3.7 and 3.9. Finally, many of the exceptions are subject to definitive time limits, thereby providing only temporarily relief, during a period of transition.

For these reasons, we do not see a need for further changes to the current exemptions that exist in relation to the requirement that every audit committee member be independent. However, if the CSA decides to amend the requirements, we recommend it follow the structure described above: clearly identify the reasonable exception, ensure appropriate safeguards are in place, and when possible, specify time limits within which the exception applies.

Are there other changes we should consider? Please explain.

The CSA should consider augmenting the definition of financial literacy as prescribed in NI 52-110 (1.6), such that it is more closely aligned with section 407 of the Sarbanes-Oxley Act of 2002. The Canadian definition is overly broad. It only requires that an individual be able to read and understand a set of financial statements that present the breadth and level of complexity of accounting issues that can reasonably be expected to be raised by the issuer's financial statements.

In contrast, the U.S. Securities and Exchange Commission (SEC) has adopted rules that directly require the individual to have an understanding of GAAP, its application to accounting estimates, accruals and reserves, and an understanding of internal control over financial reporting, among other criteria. Additionally, it requires the individual to have experience either preparing (or supervising others engaged in) auditing, analysing or evaluating financial statements.

There are many well-qualified individuals in Canada who exceed even the more robust definition of an audit committee financial expert (ACFE) prescribed by the SEC. Therefore, we encourage the CSA to consider augmenting their definition of financial literacy. We believe that requiring an audit committee to have at least one “ACFE” who has a deeper understanding of accounting rules and auditing standards than is currently required, would benefit Canadian issuers.

Part of the risk of our current structure, is that an independent audit committee member who only has a cursory understanding of financial statements may be too easily influenced by other members of the committee. In contrast, an independent audit committee member with a deeper understanding of the complexities of audit and accounting will be better prepared to objectively inform their decisions.

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

As outlined in your consultation paper, certainty, consistency and predictability are key advantages to maintaining the current approach to independence, while the disadvantage relates primarily to missing out on otherwise qualified individuals, who are precluded from being a director due to the inflexibility of existing parameters.

With regards to expanding the pool of potential candidates, the CSA should consider whether there is actually a lack of qualified independent directors under the current regime, and if so, whether it is the independence regime that is creating a lack of supply, or some other bias.

The risks of updating Canada’s independence parameters include complicating the director selection process for inter-listed issuers, especially if the new rules diverge from the U.S. approach. Furthermore, a change in Canadian rules to make them more flexible, may be seen as weakening the integrity of independent board members, by allowing formerly excluded individuals to be eligible.

We recommend that Canada maintain a rules-based approach that is as least as strict as the approach taken by U.S. Securities and Exchange Commission, and that the CSA give thoughtful consideration to all feedback that it receives during this consultation process.

Closing Comments

We appreciate the opportunity to provide these comments and look forward to the CSA's next steps on this important issue.

Yours truly,

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President and Chief Executive Officer

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