

May 21, 2004

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Securities Administration Branch, New Brunswick  
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Registrar of Securities, Government of Yukon  
Registrar of Securities, Department of Justice, Government of the Northwest Territories  
Registrar of Securities, Legal Registries Division, Department of Justice, Government of  
Nunavut

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Re: Response to Proposed Multilateral Policy 58-201 and Instrument 58-101

Please find attached the comments of the Ethics Practitioners' Association of Canada (EPAC) on your proposals regarding effective corporate governance. We would welcome an ongoing dialogue in the interests of advancing this very important file.

Sincerely,

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Chair, Ethics Practitioners' Association of Canada

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# EPAC Response to the OSC Proposals on Effective Corporate Governance

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The Board of Directors of the Ethics Practitioners' Association of Canada (EPAC) appreciates this opportunity to comment on the proposals of the Ontario Securities Commission and certain other members of the Canadian Securities Administrators (hereafter collectively called the OSC) on the subject of a multilateral policy on effective corporate governance (58-201) and a related multilateral instrument (58-101).

## What is the Ethics Practitioners' Association of Canada?

- EPAC is a national non-profit organization composed of ethics practitioners in the private, public and voluntary sectors. These practitioners include ethics officers in organizations, ethics consultants and individuals teaching or studying applied ethics. EPAC has been active across Canada since 1996.
- The EPAC **vision** is that all Canadian organizations, whether public, private or voluntary, will operate in an exemplary ethical and socially acceptable manner at home and abroad, in accordance with their own stated values, leading standards in their sector, and applicable international standards.
- The EPAC **mission** is to enable individuals to work successfully in the field of ethics organizations by enhancing the quality and availability of ethics advice and services across Canada.
- EPAC promotes ethical practices in Canadian organizations and enhances the role of ethics practitioners. EPAC offers a wide range of opportunities to share information and education about organizational ethics. EPAC maintains and improves the qualifications and standards of the profession.
- All members of EPAC must certify their adherence to the *Ethical Standards for Members*. EPAC has also established the *Competency Profile of Ethics Practitioners* and the accompanying *Competency Self-Assessment Guide*. To help individuals fill the gaps identified in their self-assessment, EPAC has produced the *Inventory of Education and Training Resources for Applied Organizational Ethics in Canada*. (For further information, see <http://www.epac-apec.ca/>.)

EPAC would like to compliment the OSC for making thoughtful proposals; however, EPAC is also of the view that the proposals fall short of what Canadian issuers need and deserve in the area of effective corporate governance. **EPAC sees a great opportunity for OSC to explore leading edge thinking in ethics and governance.**

In what follows, we set out some general considerations and then focus on an important aspect of effective governance that we feel is insufficiently addressed in the OSC proposals: the importance of values and ethics in corporate governance and how to ensure this aspect is well managed. Then, we will respond to the specific questions in the Request for Comments, followed by an outline of issues that go beyond the OSC proposals but that we feel must be addressed. We close with final remarks.

## **1. General Considerations**

EPAC supports strategies that enhance ethical corporate governance without the detailed legislative measures typical in the US. American-style legal involvement has severe downsides (e.g. making corporate governance too much a lawyers' game of looking for loopholes in stacks of regulations).

EPAC supports going another way in Canada, and the OSC has indeed tried to do that. However, the “comply-or-explain” approach does not go far enough to raise the bar on ethical behaviour. In fact, in two areas, the OSC approach reduces current requirements: dropping the requirement to name independent directors (only the number would now be provided) and dropping the reporting on governance in annual reports (reports would now be in the Annual Information Forms only).

EPAC supports the development of a more robust Canadian model. Improving the Canadian model is in the OSC's interest in order to retain the favoured status in the US markets that Canadian issuers now enjoy.

## **2. Recommended Approach to Effective Corporate Governance**

EPAC's recommended approach is based on the emerging consensus that values and ethics are an essential component of any strategy to ensure effective corporate governance. Increasing numbers of stakeholders in Canadian society and the markets of western democracies recognize that ethical management has major benefits for customer loyalty, product reputation, investor confidence, employee productivity, and risk reduction. The focus on core values and sound ethics, which is the hallmark of ethical management, is also being recognized as the best way to ensure the long-term effectiveness of corporate governance structures and procedures.

A key governance mechanism identified by the OSC is the “written code of business conduct and ethics”. Such codes are important since they can contribute to ensuring ethical behaviour throughout the corporation. The Board of a corporation is ultimately responsible for ensuring all managers and employees know what is expected of them. The Board should also be responsible for ensuring the core values of the organization are clearly communicated and encouraged, and that the necessary initiatives are put into place to ensure this.

However, the existence of a code, in itself, does not ensure proper practices, as recent scandals have demonstrated. There needs to be a comprehensive view where training, dialogue, advice

and monitoring also contribute to ensuring ethical behaviour. Therefore such initiatives, which are already part of Canadian corporate best practices, should be included in the proposed guidance.

Boards of directors also need to take into account the possible impact of managerial philosophy and example on the conduct of the corporations' managers and employees. Setting realistic objectives, and ensuring that management perks such as options, bonuses, etc., do not contribute to improper practices, are crucial. Thus, the adoption of a code, although necessary, can be seen as clearly insufficient for corporations in our present business and social context.

EPAC strongly recommends a broader, more integrated approach to ensuring long-term, effective corporate governance. The essential elements of that approach are outlined below. It is to be noted that one of the recent alternative proposals of the British Columbia and Alberta securities commissions and Quebec's Autorité des marchés financiers is aimed in the same direction recommended here – we refer to the proposed requirement to describe what steps the board of directors takes “to encourage and promote a culture of ethical business conduct”.

### **Components of the Approach**

- There are six components in the approach: principles, expectations, education, dialogue, monitoring and accountability.

### **General Guiding Principles**

- Effective measures with regard to ethics and values in corporate governance would be useful for all corporations, not just issuers.
- Strategies adopted by corporations, in corporate governance or other management decisions, should not only take into account certain governance standards and guidelines that have evolved through legislative and regulatory reforms and such, but also be aligned with government standards, business best practices and standards and any applicable global conventions (anti-bribery, auditing, etc). The proposed instruments should reflect this, namely by broadening the best practices considered and referring to these other components.
- Strategies with regard to values and ethics will apply at two levels – at the level of OSC policy and guidance, and also at the level of corporate application of the policy and guidance.
  - Thus, for example, the OSC itself as well as corporations should have a code of ethics.
- Strategies must be developed in the context of both controlling corruption and building integrity. This means providing support mechanisms in addition to compliance mechanisms.
- Strategies must go beyond obeying the law to include:
  - Social responsibility. The foundational principle is expanding governance to include ethics and values.
  - Expanded leadership obligations that go beyond legal compliance to include ethics and values. This would include establishing the leadership

obligations for ensuring awareness of expectations, decision-making approaches, ethical risk identification and mitigation strategies, and for providing opportunities for ethics dialogue and expression of concerns in a safe environment.

- Establishing clarity of ethical relationships with clients and sub-contractors.

### **Clarifying Expectations**

The provisions related to the Code of business conduct and ethics should be enhanced in order to provide sufficient guidance and also take into account current best practices in Canadian organizations. We suggest adding the following:

- A clear declaration of values and ethics. The Code should specify the corporation's core values and give guiding principles to help decision-making when individuals are faced with grey areas or situations of conflict where the code does not provide sufficient guidance.
- A support component (including a dialogue element in addition to the enforcement element).
- A compliance component (that is, enforcement elements). The code, and other initiatives, should strike a balance between compliance and enforcement components and internal dialogue on the organization's core values and how these can be upheld in day-to-day practices.

### **Providing Education and Training**

EPAC believes that proper development and learning strategies are essential to encouraging ethical conduct at all levels. This is also already part of current best practices in Canadian organizations and should be mentioned in the guidelines. The core is that:

- Training should be provided to managers at all levels on an on-going basis, not only on the code but also on ethical leadership and ethical decision-making.
- The "comprehensive orientation" suggested for all board members in the proposal should specifically include a components on ethics.
- Training and education opportunities and activities should be available for new employees, new corporations, corporate transgressors, investors and the public.
- OSC should help or promote corporate awareness of education requirements, best practices and evolving principles.
- Corporations will be responsible for educating their employees
- OSC and corporations will, in spirit of transparency and awareness, help educate investors and the general public.

## **Consultation, Dialogue and Advisory Capacities**

Advisory services (such as ethics officers, advisors or counsellors, or ombudsmen) assist employees to do the right thing, and are separate from recourse mechanisms for disclosing and dealing with wrongdoing (corporate counsel, compliance officers, etc.).

- The OSC should provide advisory capacity to corporations, investors and the public.
- Corporations should provide advisory capacity to employees and suppliers.

## **Monitoring and Reporting**

Given the need to provide practical and affordable solutions, EPAC supports:

- OSC and external audit and investigation strategies, but
- EPAC also supports corporate “assess and report” strategies that encourage transparency and voluntary disclosures.

## **Ensuring Accountability**

EPAC recommends that the OSC proposal be expanded beyond legal compliance to other reconciliation options (for example, an approach using disclosure, corrective opportunities, mediation, and reconciliation, before resorting to legal measures).

# **3. Responses to the Specific Questions in the Request for Comments**

## **OSC Question 1**

*1. The Proposed Policy and Proposed Instrument describe best practices and require issuers to make disclosure in relation to those best practices.*

- (a) Will these initiatives provide useful guidance to issuers?*
- (b) Will these initiatives provide meaningful disclosure to investors?*
- (c) Would disclosure be more meaningful to investors if issuers were required to describe their practices by reference to certain categories of governance principles rather than by reference to the best practices described in the Policy?*
- (d) What will be the effect on market participants, including investors and issuers, of our publishing best practices in Canada?*

## **EPAC Response**

1. (a) & (b) The initiative proposed in this area will have some benefits; however, we believe that the elements we have put forward in this paper would provide a more robust model for Canada. In any case, regularly updating the guidance provided in effective corporate governance is crucial.  
  
(c) EPAC strongly supports the OSC providing more guidance to issuers on both principles and best practices.

(d) The effect should be positive over time – one goal is certainly the enhanced education of issuers and investors.

## **OSC Question 2**

*2. The Proposed Instrument does not require an issuer to adopt a code of ethics, but issuers who do not have one must explain why they do not. If an issuer does adopt a code, the Proposed Instrument requires the issuer to file the code, as well as any amendments on SEDAR. It also requires an issuer to prepare and file a news release respecting any express or implied waiver of the code.*

*(a) Will the text of the code of ethics provide useful disclosure for investors?*

*(b) Will disclosure of waivers from the code provide useful disclosure for investors?*

*(c) Since there is no requirement to have a code of ethics, will the obligations respecting filing the code and any amendments and reporting waivers from the code have the effect of discouraging issuers from adopting a code of ethics?*

## **EPAC Response**

2. (a) Yes, the text of the code of ethics should be provided to investors. Providing the text of a code is a very minimal requirement, which does not indicate to investors, shareholders or other companies whether this is boilerplate material or part of a corporate strategy that describes how they do business. Companies should have to report on steps taken by the board and company to teach individuals how to integrate the code into their decision-making and everyday practices.

(b) EPAC disagrees with the principle of waivers – if there is a major problem with an issuer’s code, the issuer should fix the code and publish it. If there is a minor problem with a code, the issuer should disclose the explanation of the action taken.

(c) The EPAC strategy would require a statement of values and ethics based on generally accepted understandings of integrity and related principles.

## **OSC Question 3**

*3. The Proposed Instrument does not require issuers to have a compensation committee, nor does it require that committee to be entirely independent or to have a charter, but if an issuer does not have these structures, it must explain why not. An issuer is required to state whether it has a compensation committee, whether that committee is independent and whether it has a compensation committee charter. If there is a charter, the text of the charter must be disclosed. Additionally, the Proposed Instrument requires an issuer to disclose the process used to determine compensation, but that disclosure is only required if the issuer does not have a compensation committee.*

*(a) Would it be useful to investors for the issuer to disclose the process used to determine compensation, regardless of whether it has a compensation committee?*

*(b) Is disclosure of the text of the compensation committee’s charter useful to investors?*

## **EPAC Response**

3. (a) & (b) In the spirit of maximizing transparency and accountability, the process used to determine compensation and the compensation committee’s charter should be disclosed. Limits, if any, on company ownership or exercising of options that are set by the

company should also be disclosed. The OSC should identify best practices in this area to encourage companies to require stocks or options acquired by a director to be held for a number of years after a board member departs to avoid conflicts that might arise when balancing short-term stock prices against the long-term financial sustainability of the company.

#### **OSC Question 4**

*4. The Proposed Instrument does not require issuers to have a nominating committee, nor does it require that committee to be entirely independent or to have a charter, but if an issuer does not have these structures, it must explain why not.*

*An issuer is required to state whether it has a nominating committee, whether any such committee is independent and whether it has a nominating committee charter. If there is a charter, the text of the charter must be disclosed. Additionally, the Proposed Instrument requires an issuer to disclose the process by which candidates are selected for board nomination, but that disclosure is only required if the issuer does not have a nominating committee.*

*(a) Would it be useful to investors for the issuer to disclose the process by which candidates are selected for board nomination, regardless of whether it has a nominating committee?*

*(b) Is disclosure of the text of the nominating committee's charter useful to investors?*

#### **EPAC Response**

4. (a) & (b) In the spirit of maximizing transparency and accountability, the process for selecting board nominees and the nominating committee's charter should be disclosed. The report should also indicate other boards that all of the directors sit on to disclose if any board members may have potential conflicts and also to disclose how many of the board members sit together on other boards.

#### **OSC Question 5**

*5. The Proposed Instrument requires an issuer to disclose the process used to assess the performance of the board, committee chairs and CEO, but that disclosure is only required if the issuer does not have written position descriptions for those roles. Would it be useful for investors for the issuer to disclose the assessment process, regardless of whether it has written position descriptions?*

#### **EPAC Response**

5. Yes, the assessment process for board and CEO performance should be disclosed.

#### **OSC Additional Question**

*Considerations regarding the application of the Proposed Materials to income trusts and other similarly structured entities.*

#### **EPAC Response**

EPAC makes no specific recommendations about income trusts, but emphasizes that its recommended approach should be applied as widely as possible.

## 4. Issues that Go Beyond the OSC Proposals

Here in outline form, are three areas for recommended action:

1. **Education and research.** There is an urgent need to support education requirements and initiatives by corporations and by the OSC itself. (An example is initiatives like the Directors College established by the DeGroot School of Business at McMaster University and the Conference Board of Canada.) There is also a need for further applied research on governance initiatives that enhance profitability, and that better consider ethics, values and social responsibility. A crucial issue is to find funding for such training and research – it is proposed that the OSC's fund of fines would be appropriate.
2. **Legislation.** The legislative context should be reviewed for improvement opportunities and areas where OSC can better support innovation and change. Opportunities may include creating a national body for securities oversight, and a specialized court with justices and prosecutors thoroughly familiar with business law, as well as enhancing the police or other enforcement capacity.
3. **The role of the corporation in society.** The OSC together with a variety of players should provide ongoing support for the position that corporations have responsibilities for ethical behaviour in society. Corporations have been given special advantages by society (e.g. charters with limited liability but no time limit) and are ultimately accountable to society for their behaviour.

## 5. Closing Remarks

In this submission, EPAC has sketched an approach to enhancing the OSC proposals so as to achieve a broader, deeper, more lasting governance model that is also more likely to enable Canadian issuers to maintain their favoured status in American markets. It must be emphasized that EPAC's approach recognizes the need for a flexible Canadian model. EPAC recommends expanding on the OSC proposals with both best practices and specific reporting requirements, but does not advocate an American-style fully mandatory regime.

Numerous aspects of the EPAC model clearly require further elaboration. EPAC would be prepared, within the constraints of its resources, to assist in the development of more detailed proposals should the OSC decide to move towards a truly robust Canadian approach.

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