

Corporate Securities

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Senate Banking Committee Speaks On Corporate Governance

On June 19, 2003, yet another voice was added to the growing debate regarding Canada's corporate governance framework. Specifically, the federal Senate Committee on Banking, Trade and Commerce released a report following its study of the likelihood of corporate scandals of the type seen in the United States occurring in Canada and, more importantly, of how such scandals might be avoided. Given the initiatives in this area being announced by various regulatory bodies, including the Ontario Securities Commission (the "Commission") and the Toronto Stock Exchange, there is some potential for confusion in the regulation of corporate governance in Canada. The Committee stated:

"The Committee is fully aware of the actions taken recently by a number of stakeholders in Canada, including professional organizations, securities commissions, stock exchanges, governments and others. We applaud their initiatives, feeling that they will contribute to restored investor confidence. Nevertheless, we feel that regimes that involve mandatory disclosure and voluntary compliance, voluntary rules, or policies developed by boards and self-regulating organizations do not go far enough and do not have the same effect as legislated and regulatory requirements... It was for this reason that, in a number of areas, the Committee has recommended legislative initiatives."

Certain of the recommendations made by the Committee appear to be beyond the ambit of the *Canada Business Corporations Act* which, in any event, is applicable only to federally incorporated companies, while others are similar to anticipated rules of the Commission. The recommendations do, however, reflect a serious consideration of governance issues. It remains to be seen to what extent the recommendations do find their way into the CBCA or influence provincial legislation.

The Recommendations

In making its recommendations, the Committee concluded that, if legislated, these initiatives will contribute to restored investor confidence through Canadian leadership in transparency and good governance, making Canada "a magnet for investment and enabling economic growth". The Committee recommended, among other things, that legislation be introduced which provides for the following:

- A majority of the members of the board of directors (of public companies) must be independent, recognizing special circumstances that may be faced by closely held corporations and small and medium-sized businesses. The independent directors should be required to meet *in camera* on a periodic basis and the board of directors should be required to adhere to a code of ethics.
- All audit committee members must be independent and "financially literate" and at least one member should be a "financial expert". The audit committee should have the ability to select and

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take advice from an independent audit advisor and *in camera* meetings between the audit committee and the auditor should be mandatory.

- Members of management should not serve on the compensation committee and compensation committee members should have a level of expertise in the areas of compensation and human resource management. Additionally, the compensation committee should have the ability to select and take advice from an independent compensation consultant and be required to hold *in camera* meetings with the company's compensation consultants.
- Non-audit services provided by auditors to their audit clients should be limited, although these restrictions should not necessarily apply to small and medium-sized businesses. The rules developed by the Canadian Public Accountability Board should be used as a guideline for the legislation. Moreover, the audit committee (not management) should be charged with the responsibility of overseeing the auditor and the lead audit partner must be rotated every seven years.
- Whistleblower protection should be introduced for employees with respect to the reporting of financial irregularities and failed corporate governance.
- The role of chief executive officer and chairman of the board of directors should be split, with possible exceptions for closely held companies and small and medium-sized businesses.
- The chief executive officer and chief financial officer of an issuer must certify that the annual financial statements of the issuer fairly present, in all material respects, both the results of operations and its financial condition.

Please do not hesitate to contact any member of the Goodmans corporate securities team to discuss corporate governance as it continues to evolve in Canada.

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