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**“Corporate Governance: The Regulator’s Perspective”**

Thank you and good morning everyone. I’m very pleased to be here to participate in this session on corporate governance.

I joined the OSC earlier this year as Vice Chair after almost 20 years as a litigator.

While my remarks have been billed as “The Regulator’s Perspective”, I think it is best said that these remarks are rather just “A Regulator’s Perspective” and a freshly minted one at that.

What I have to say this morning are my own views and observations on corporate governance issues. They are, in part, based on my experience so far, at the Commission.

But they are largely informed and influenced by my years acting for issuers and registrants in enforcement regulatory matters and corporate commercial and securities litigation and in providing advice on conflict and dispute resolution and avoidance. They may not necessarily reflect the current position of the OSC staff, but hopefully, in time, they will.

I’d like to try to convey to you how I see corporate governance regulation, to provide some thoughts on where I think Canada is, and will continue to be, in this vital area. I look forward to your questions after I finish my formal remarks.

## **Progress in Corporate Governance**

As a basic premise, the best corporate governance regime is one that instills and maintains confidence in investors that the company will be properly and effectively governed – that its interests as a whole, over any of its individual stakeholders or managers, will be pursued; and that it will be able to uncover or otherwise respond to any improprieties when they arise.

In my view, our job as regulators is to encourage and facilitate such a regime, and to provide guidance on what we think that entails. The form of that encouragement and its substantive content may be determined by a number of factors, including philosophical ones as to how much we think is appropriate to leave to each company to meet principled objectives through means set in their own judgment – or in contrast, what hard and fast rules are needed to maintain investor confidence.

But the essence of the objective remains clear: to develop and implement the most effective system and procedures to best ensure the goals of the company are pursued and the rights of investors are preserved and protected.

As a litigator for almost two decades, I was quite involved in securities enforcement matters. I acted as enforcement counsel for the OSC for about a year, and then acted for public companies, their officers, directors and boards on enforcement related matters. As such, I see corporate governance practices, policies, priorities and regulation through a different prism than many of you or today's presenters – except perhaps for Allan Stewart who you'll hear from after me.

I see a strong corporate governance program as one that elicits the most effective response a public company can take in a crisis:

- how does the company respond when a complaint is made internally about a manager or an officer?
- how does the company respond when it's faced with a lawsuit, particularly involving allegations of impropriety?
- how does a company respond to potential or actual conflicts of interest within the management group, or the board of directors, or both?
- how does the company manage itself when the regulator or other law enforcement agency come calling, to either request information or to investigate allegations of improprieties?

A company's corporate governance regime is often viciously tested in extraordinary circumstances and in times of crisis. So the likelihood of an extraordinary circumstance and a crisis should be assumed, in my view, when structuring, assessing and realigning one's corporate governance regime.

If that is done properly, not only should shareholders and other investors be confident that the company will weather the extraordinary circumstance or crisis, but that such events will most likely be avoided, or at least, the consequences from them will be minimized.

But good corporate governance does not mean that every possible scenario is anticipated and prepared for. Good corporate governance can often facilitate the decision to return third party experts to advise and assist in getting through an issue that may arise.

Against that backdrop, let me begin with three observations that may be fairly obvious to you: The first is that, as an area of interest for investors, issuers, regulators and lawyers, corporate governance has come a long way in a relatively short time.

It wasn't that long ago that a conference like this would have been sparsely attended – if held at all. Corporate governance was considered rather arcane or dull. Those who were interested in it were likely to be considered to be the office “nerds”.

Today, a full understanding of the appropriateness of effective corporate governance is essential to anyone involved in managing a public company, and certainly anyone who's called upon (and, in turn, is paid for) to give advice to public companies, their executives and directors.

Following on that point, I offer my second general observation: I believe it's clear that the interest in and focus on corporate governance – by business leaders, legal professionals, regulators, academics and lawmakers – is a permanent feature of corporate and investment life. It's here to stay.

Awareness of and attention to corporate governance principles and priorities is no fad. Today, we have widely attended programs such as these, presented by experts whose professional focus is largely monopolized with providing good legal and practical advice on corporate governance practices, and how best to implement them. Companies should not be shy in retaining these experts. We have organizations like the Canadian Coalition for Good Governance and the Institute of Corporate Directors; and courses being offered in universities, law schools promoting and exchanging ideas on corporate governance matters. Companies, and their officers and directors, should not be shy in attending these courses. We have chairs being created like the one at Osgoode Hall now occupied by former OSC Chair Ed Waitzer. I congratulate Osgoode Hall Law School, Ed Waitzer and his law firm for their contribution to fostering a culture of corporate governance excellence. All law schools and law firms should follow suit.

This leads to my third observation – that corporate governance is far better today than it has ever been. Boards, management – and legal counsel – are all far more committed and vigilant. And I don't believe this is simply the result of fear of litigation or regulatory intervention, although we should not discount the effectiveness of fear. But there is clearly a general raising of expectations

and standards and growing realization that, in a competitive marketplace, having good corporate governance – and being recognized for it – is a competitive advantage in raising capital.

### **Corporate Governance Today**

The promotion of good corporate governance is fundamental to the mandate of the OSC. Let me remind you of what that mandate is:

“To provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in their integrity.”

Investor protection...efficient capital markets...and confidence in the markets.

It's quite a broad mandate and requires careful balance. Investors demand opportunities in which to invest. Issuers need the capital the investors provide. That equation is what makes a market. So we, as the regulator, should not take steps on just one side of the equation, without considering the consequences to the other.

On one hand, regulators need to be careful not to mandate so many rules that issuers are overburdened and the markets could grind to a halt.

On the other hand, integrity and investor confidence demand that reasonable steps be taken to prevent investors from being defrauded or treated unfairly, and if and when such misconduct arises, investors must have confidence that a just result is likely.

Neither extreme, at the expense of the other, helps foster market efficiency or confidence in market integrity.

Above all, market participants are looking for clarity – for certainty, for consistency.

That's not to say that regulation needs to be static. Far from it. Markets are dynamic, creative and resourceful. And regulators need to keep pace. But they must do so while remaining committed to a set of principles that can guide them as they face new situations.

Understanding of, and adherence to, principles allows regulators to adapt more quickly to change in the marketplace. Sticking to principles means we know how to approach new challenges. They also help us focus on what is important rather than over-reacting to short-term issues that are not fundamental. Consistency and clarity are clearly helpful to us as regulators and investors.

They are just as helpful to you as legal counsel to issuers, registrants and investors. Your understanding of those principles means you can advise your clients more effectively about the probable response of the OSC to actions your clients may be considering.

Balance, clarity, certainty and consistency, I believe, are the keys to effective regulation, and to instilling and maintaining confidence in the capital markets.

It's within that context that we can look more specifically at corporate governance because it's clear that good corporate governance is an essential foundation of capital market regulation.

So what does all this mean for the OSC's approach to corporate governance regulation?

Well, it describes why the OSC and CSA have been, and continue to be, reluctant to impose a "one size fits all" set of rules on most corporate governance matters. We recognize that the best standard of corporate governance is based on the decisions that individuals make every day. It's based on personal behaviour, on ethics, on "corporate culture", if you will. And, personal ethics and good judgment cannot be enacted by the legislature or established by regulation. And they can't be adequately enforced by any regulator, judge or jury.

Regulators and lawmakers can't develop rules for every conceivable situation and risk-reward business model. And regulators certainly can't monitor every move by every market participant. That's not only unrealistic: it would be counterproductive to maintaining vibrant markets.

What we can do, however, is to try to articulate principles and standards that help all market participants understand what kind of behaviour is expected and consistently apply and enforce them. In doing so, regulators can help corporations govern themselves; this includes encouraging a governance regime that enables them to effectively deal with issues that arise and take appropriate action that meets the expected standards.

Our role – our duty – as regulators, is to help define certain standards for issuers to promote and enforce internally and to be available with enforcement, hopefully as a last resort, when issuers are unable or unwilling to comply. We can do this by clearly establishing corporate standards and governance criteria. Defining standards for better record-keeping, greater internal accountability, and enhanced disclosure about how those efforts are being pursued. And we can do this through a strengthening of our commitment to compliance reviews and initiatives that help point issuers in the right direction without necessarily resorting to enforcement steps.

This view is consistent with what the OSC executive team refers to as the “compliance-enforcement continuum”. Simply put, this means that we cannot, and should not, try to solely rely on enforcement activity to affect and change behaviour of market participants. Investigating, holding regulatory hearings, and prosecuting in court when warranted, is sometimes necessary, and effective, but is at one end of the continuum. At the other end is the cooperative, consultative approach. It means encouraging and guiding issuers to comply with the highest standards of corporate governance.

Again, it's a question of balance. It's unrealistic to expect everyone to comply with the standards of good corporate governance without the potential threat of enforcement and litigation. But, in my view, it's just as unrealistic to expect enforcement alone to encourage good governance. A

few highly publicized “perp walks” and prosecutions – or even hundreds – will simply not be as effective in protecting investors as fostering a strong culture of compliance.

As I said at the outset, an effective corporate governance regime often reduces the incidence of non-compliance and therefore the need for regulators to proceed on enforcement matters. Good corporate governance means effective self-policing.

That’s the approach we’re trying to take at the OSC. We’re trying to set clearer standards for better corporate governance, while resisting the imposition of prescriptive rules or requirements to achieve that goal, which some commentators claim to be onerous, time-consuming and expensive.

But we also can’t look at Ontario in isolation, either. The capital markets are global, and, increasingly, our ability to act independently is limited. We’re competing with and in international markets on a daily basis, as issuers and investors look at where they can find the best balance of opportunity and safety. The test for us is to ensure that we do not merely react to these pressures. Rather, that we properly respond to the underlying issues, in a manner that is principled, focused and consistent with what’s best for Ontario.

What is one way we seek to achieve this culture of good corporate governance? Well, like Francis Bacon, we believe: “Knowledge is power.”

Knowledge, in the capital markets, means disclosure. And the promotion of disclosure has given rise to making boards and audit committees and management accountable for their actions. It means putting information about those actions in the hands of investors and allowing the investors to decide if the behaviour of the issuer is acceptable. If investors know what they should expect – from, for example, OSC regulations – and if the issuer is required to disclose how it surpasses or falls short of those standards, investors can make an informed decision. That’s power.

In my view, a regulatory environment based on public disclosure enhances a culture of corporate governance.

### **The OSC's Regulatory Response to Corporate Governance Issues**

So what have Ontario and other Canadian regulators done with respect to corporate governance regulation. Enron and other corporate scandals in North America resulted in a set of significant regulatory reforms and the subsequent enactment of the Sarbanes-Oxley Act (SOX) in the United States in 2002, pushed Canada to take a look at its own corporate governance practices and institute some changes. On one hand, there was a widely-held perception that these changes had to be as robust as that of the U.S. to equally restore investor confidence in Canadian capital markets. On the other hand, these changes had to be accommodating to our distinct characteristics.

Properly, in my view, the Commission aimed to strike a regulatory balance: to improve the system of corporate governance without adding undue burden on market participants. We had to be careful not to over-regulate. We chose to endorse an approach that allowed some flexibility in regulation, while addressing the concerns reflected in the Sarbanes-Oxley reforms.

### **Canadian Responses to SOX**

Rather than dictating prescriptive rules for running businesses, the Commission's policies emphasized a set of regulatory outcomes for companies to achieve while giving them the latitude to structure their own businesses.

## **Corporate Governance**

For example, the Commission implemented the Corporate Governance Guidelines (NP 58-201), which articulate a set of governance principles in the form of best practices for companies to take into account when developing their own policies. These include guidelines such as, maintaining a majority of independent members on the board; setting out duties and responsibilities for each position on the board; adopting a code of business conduct and ethics; and, establishing independent nomination and compensation committees.

Although these guidelines don't form a mandatory check-list, they provide a benchmark against which companies could measure their own governance policies. The companion Disclosure Rule (NI 58-101 *Disclosure of Corporate Governance Practices*) requires issuers to disclose their corporate governance practices relevant to the guidelines. If the best practices are not adopted, the company must indicate how their underlying objectives are achieved, such as how the board facilitates independent judgment in carrying out its function.

The CSA recognizes that a different approach may be appropriate to address the various investor risk tolerances associated with different types of business arrangements, including closely-controlled companies. In 2006, the Commission undertook to review the impact of the guidelines and related disclosure requirements on closely-controlled companies. It's important that we continue to review our rules and requirements to account for the unique and/or evolving interests to the shareholders, and this reflects the Commission's commitment to doing so.

## **Audit Committees**

The Audit Committee Rule (MI 52-110) addresses the independence and responsibilities of the audit committees of the boards of directors. Companies are now required to have an independent audit committee to whom the external auditor must report directly. By barring management from any oversight role with respect to the external auditor, the audit committee requirements facilitate the independent review and oversight of a company's financial reporting processes and

the work of the external auditor. In addition, audit committees are now required to review financial disclosure prior to public release and must be financially literate.

### **Certification and Internal Controls**

The Commission also enacted a certification rule (MI 52-109) requiring CEOs and CFOs to personally certify that their financial disclosure truthfully and fairly presents their company's financial condition, cash flows and results of operations. It also requires the CEO and CFO to certify that they have designed or supervised the design of disclosure controls and procedures and internal control over financial reporting.

Canadian regulators continue to monitor developments and standards in the U.S. in relation to SOX 404 with the view of bringing their lessons north of the border.

CSA Notice 52-313 and the related proposed amendments to the certification rule contemplate, what I would call, a more relaxed version of SOX 404, requiring the CEO and CFO to evaluate the effectiveness of internal controls, but without the requirement for an external audit of management's evaluation of those controls.

With this compromise, we were able to suitably balance enhanced transparency, quality and reliability of financial disclosure for investors in Canada, without adding undue burdens on our publicly-traded companies and costs to shareholders.

### **Executive Compensation Disclosure**

As Warren Buffett said, "CEO pay remains the acid test in judging whether corporate America is serious about reforming itself." There are concerns that our executive compensation culture is not sufficiently linked to corporate performance.

Recently, the CSA unveiled its executive compensation disclosure proposals. We believe that shareholders are entitled to a simple answer of how much an executive earns—in total—without having to refer to various financial tables. Our proposals are based on the premise that shareholders have a right to know how rewards for senior management are linked to corporate performance, and whether the figures actually reflect how well the company is performing. This requires more context and clarity as to how conclusions are determined.

While the CSA is not going to tell companies how much to pay their executives, investors demand some accountability. This can be provided through disclosure of the amounts paid and the decisions behind them. Good corporate governance can only be achieved if the board of directors is able to effectively inform the shareholders. And shareholders can only take appropriate action if they're equipped with the facts.

The SEC needed almost 400 pages to reform its executive compensation disclosure rules. We have tried to take a more principles based approach rather than a prescriptive approach.

Our approach is intended to allow companies to customize their disclosure so that it communicates their own compensation objectives and policies in a meaningful way.

Comments have been received on these proposals and they raise a number of interesting issues. The CSA has recently announced that it will be giving the comments a serious consideration and will not rush into publishing its policy without doing so.

## **Conclusion**

This morning I've touched briefly on recent major developments in the evolution of our corporate governance culture. I've spoken about some of today's pressing corporate governance challenges. I'll conclude by looking forward to the future.

As I have said, corporate governance will continue to be a vital issue for the capital markets and for public policy.

In response, we hope to see an increased push from regulators – including the OSC – to create an environment in which all participants in the markets have a clear understanding of the principles and practices that are expected. In my view, the most important thing we can do as the regulator is to improve our communication to the marketplace of our standards and expectations.

In terms of corporate governance, we want to continue to strike an appropriate balance where we can enhance governance practices without having to burden public issuers with unnecessary regulations or restrictions in conducting their business. This is difficult to accomplish with a prescriptive approach. By articulating a clear set of regulatory objectives and principles, we're able to evolve our standards to adjust to changing conditions and demands of our capital markets.

Disclosure is the critical underpinning of our markets. It strengthens compliance and encourages a culture of good corporate governance. When necessary, it can be reinforced by enforcement and litigation. But the priority has to be on compliance first, enforcement second.

Finally, there's your role as counsel to issuers and investors. You have a central part to play in creating greater confidence in the public markets. You can expect your clients and regulatory authorities to ask for your help in achieving greater clarity among all market participants.

Thank you.