5.1.2 Multilateral Instrument 52-110 Audit Committees and Companion Policy 52-110CP

NOTICE

AMENDMENTS TO
MULTILATERAL INSTRUMENT 52-110 AUDIT COMMITTEES, FORM 52-110F1,
FORM 52-110F2, AND COMPANION POLICY 52-110CP

This Notice accompanies amendments to Multilateral Instrument 52-110 *Audit Committees*, Form 52-110F1 and Form 52-110F2 (together, the **Rule Amendment**) and to Companion Policy 52-110CP to Multilateral Instrument 52-110 *Audit Committees* (the **Policy Amendment**, and together with the Rule Amendment, the **Amendments**). The Amendments are an initiative of the securities regulatory authorities in every province and territory in Canada, other than British Columbia (the **Participating Jurisdictions**).

The Rule Amendment has been made, or is expected to be made, as a rule in each of Alberta, Manitoba, Ontario, New Brunswick, Nova Scotia and Newfoundland and Labrador, as a Commission regulation in Saskatchewan and Nunavut, as a policy in Prince Edward Island and the Yukon Territory, and as a code in the Northwest Territories. The Policy Amendment has been adopted, or is expected to be adopted, as a policy in each of the Participating Jurisdictions other than Québec. We intend the Amendments to come into force on June 30, 2005.

In Ontario, the Rule Amendment and other required materials were delivered to the Chair of the Management Board of Cabinet on April 15, 2005. The Minister may approve or reject the Rule Amendment or return it for further consideration. If the Minister approves the Rule Amendment or does not take any further action by June 14, 2005, the Rule Amendment will come into force on June 30, 2005.

In Québec, since Multilateral Instrument 52-110 *Audit Committees* (the **Audit Committee Rule**) and the Companion Policy 52-110CP to the Audit Committee Rule (the **Companion Policy**) have not been adopted yet, the Rule Amendment is being published as Amendment to Proposed *Regulation 52-110 respecting Audit Committees*, and the Policy Amendment is being published as Amendment to Proposed Policy Statement 52-110 to *Regulation 52-110 respecting Audit Committees*.

In Alberta, the Rule Amendment and other materials were delivered to the Minister of Finance. The Minister may approve or reject the Rule Amendment. Subject to Ministerial approval, the Amendments will come into force on June 30, 2005. The Alberta Securities Commission will issue a separate notice advising whether the Minister has approved or rejected the Rule Amendment.

Background to the Audit Committee Rule

The Audit Committee Rule was an initiative of the Participating Jurisdictions. The Audit Committee Rule was adopted as a rule in each of Alberta, Manitoba, Ontario, Nova Scotia and Newfoundland and Labrador, as a Commission regulation in Saskatchewan, as a policy in New Brunswick, Prince Edward Island and the Yukon Territory, and as a code in the Northwest Territories and Nunavut. The Companion Policy was implemented as a policy in Alberta, Manitoba, Ontario, Nova Scotia, Newfoundland and Labrador, Saskatchewan, New Brunswick, Prince Edward Island, the Yukon Territory, the Northwest Territories and Nunavut. In most jurisdictions, the Audit Committee Rule and the Companion Policy came into force on March 30, 2004. In Québec, the Audit Committee Rule will be adopted as a regulation made under section 331.1 of *The Securities Act* (Québec) once it is approved, with or without amendment, by the Minister of Finance, and will come into force on the date of its publication in the *Gazette officielle du Québec* or on any later date specified in the regulation. The Companion Policy will be implemented as a policy in Québec.

The purpose of the Audit Committee Rule is to encourage reporting issuers to establish and maintain strong, effective and independent audit committees. We believe that such audit committees enhance the quality of financial disclosure made by reporting issuers, and ultimately foster investor confidence in Canada's capital markets. The purpose of the Companion Policy is to provide interpretative guidance for the application of the Audit Committee Rule.

The Audit Committee Rule is based upon similar audit committee requirements applicable in the United States. In particular, it is derived from the audit committee requirements administered by the U.S. Securities and Exchange Commission (the **SEC**), as well as the listing requirements of the New York Stock Exchange (**NYSE**) and Nasdaq Stock Market.

Background to the Amendments

The Amendments were published on October 29, 2004 for a 90 day comment period.

We proposed the Amendments for two principal reasons:

(i) *Clarification of the Definition of Independence*

The Audit Committee Rule contains a definition of independence that is generally applicable to audit committee members. In developing this definition, we attempted to parallel, as much as possible, the definitions of independence applicable to members of audit committees of U.S. listed companies. In the United States, for an audit committee member to be considered independent, the member must satisfy two distinct requirements:

(i) the member must be independent within the meaning of section (b)(1) of SEC Exchange Rule 10A-3 (the **SEC Independent Audit Committee Member Requirements**); and

(ii) the member must be an independent director as defined by the listing requirements of the applicable exchange or market (the **Exchange Independent Director Requirements**).

Our definition of independence (found in section 1.4 of the Audit Committee Rule) was designed to incorporate into a single set of requirements the key elements of each of the SEC Independent Audit Committee Member Requirements and the Exchange Independent Director Requirements.

Concurrently with publishing the Amendments for comment, the securities regulatory authorities in every jurisdiction in Canada also published for comment proposed National Policy 58-201 *Corporate Governance Guidelines* (the **Governance Policy**) and proposed National Instrument 58-101 *Disclosure of Corporate Governance Practices* (the **Governance Disclosure Rule**). The purpose of the Governance Policy is to provide guidance on corporate governance practices. The purpose of the Governance Disclosure Rule is to provide greater transparency for the marketplace regarding issuers' corporate governance practices. Both the Governance Policy and the Governance Disclosure Rule use a definition of independence that is consistent with the Exchange Independent Director Requirements.[1]

A primary purpose of the Amendments is to divide the existing definition of independence in section 1.4 of the Audit Committee Rule into two separate sets of requirements: one corresponding to the SEC Independent Audit Committee Member Requirements, and the other to the Exchange Independent Director Requirements. This division permits a convenient cross-reference in the Governance Disclosure Rule and the Governance Policy to the Exchange Independent Director Requirements contained in the Audit Committee Rule.

(ii) *Update to the Definition of Independence*

On November 3, 2004, the NYSE amended Section 303A of the NYSE Listed Company Manual (the **NYSE Amendment**). The NYSE Amendment made a number of changes to the NYSE's corporate governance rules, most importantly those dealing with "bright line tests" for director independence. The Amendments incorporate many, though not all, of the changes contained in the NYSE Amendment. See "*Summary of Principal Changes to the Amendments*", below.

We have also taken this opportunity to make certain other minor amendments to the Audit Committee Rule and Companion Policy.

Summary of Written Comments Received

We received submissions from three commenters regarding the Amendments. Four parties provided comments on the Amendments in the context of providing comments on the Governance Policy and Governance Disclosure Rule. We have considered all the comments received and thank all the commenters. The names of the commenters are contained in Schedule A of this Notice.

A summary of the comments we received, and our responses to those comments, is contained in Schedule B of this Notice.

Summary of Principal Changes to the Amendments

The Amendments differ from those published for comment on October 29, 2004 in the following manner:

The Rule Amendment

- Section 1.4 of the Rule Amendment expands the "controlled company exemption" contained in subsection 3.3(2) of the Audit Committee Rule. Previously, this exemption was only available to an individual who would be independent but for the relationship described in clause 1.5(1)(b) of the amended Audit Committee Rule.

1. The SEC Independent Audit Committee Member Requirements apply only in the context of audit committees.

However, with the adoption of subsection 1.4(8) of the amended Audit Committee Rule, it became necessary to expand this exemption. The exemption now applies to an individual who would be independent but for the relationship described in clause 1.5(1)(b) or as a result of subsection 1.4(8) of the amended Audit Committee Rule.

- In our request for comments dated October 29, 2004, we proposed to amend certain elements of the definition of independence to more closely parallel the NYSE Amendment proposed on August 3 and August 30, 2004. One of these changes was to narrow the prescribed relationship described in clause 1.4(3)(d) of the Audit Committee Rule so that it would apply to only a "spouse, minor child or stepchild, or child or stepchild who shares a home with the individual" rather than a individual's immediate family member.[2]

  Subsequently, the NYSE determined not to narrow the scope of its corresponding prescribed relationship. As a result, the NYSE's corresponding prescribed relationship continues to refer to the broader definition of "immediate family member". Nonetheless, we have decided to retain the narrower prescribed relationship in the Rule Amendment, as we believe that that it identifies those relationships that would reasonably be expected to interfere with the exercise of an audit committee member's independent judgement without being inappropriately broad. Issuers are reminded, however, that notwithstanding the revisions to clause 1.4(3)(d), a member will only be independent if he or she does not have a direct or indirect material relationship with the issuer.

- Section 1.3 of the Rule Amendment has been revised. It now amends subsection 1.4(4) of the Audit Committee Rule to provide that an individual will not be considered to have a material relationship with the issuer solely because he or she had a relationship identified in subsections 1.4(3) by virtue of subsection 1.4(8), provided that the relationship ended before June 30, 2005.

The Policy Amendment

- Paragraph 1.2 of the Policy Amendment adds a new paragraph 3.4 to the Companion Policy. It notes that subsection 1.4(6) of the amended Audit Committee Rule provides that, for the purpose of the prescribed relationship described in clause 1.4(3)(f) of the amended Audit Committee Rule, direct compensation does not include remuneration for acting as a member of the board of directors or of any board committee of the issuer. The paragraph goes on to state that, in our view, remuneration for acting as a member of the board also includes remuneration for acting as the chair of the board or of any committee of the board.

- The Policy Amendment clarifies the guidance in paragraph 4.2 of the Companion Policy. Specifically, it is intended to clarify that a detailed understanding of accounting principles is not implied in the definition of "financial literacy". The definition of "financial literacy" is separate and apart from the requirement to disclose each audit committee member's relevant education and expertise, as found in Item 3 of Forms 52-110F1 and 52-110F2.

Authority for the Audit Committee Rule -- Ontario

In Ontario, securities legislation provides the Ontario Securities Commission (the **OSC**) with rule-making authority regarding the subject matter of the Amendments and the Audit Committee Rule.

Paragraph 143(1)57 of the *Securities Act* (Ontario) authorizes the OSC to make rules requiring reporting issuers to appoint audit committees and prescribing requirements relating to the functioning and responsibilities of audit committees, including requirements in respect of the composition of audit committees and the qualifications of audit committee members, including independence requirements.

Anticipated Costs and Benefits of the Amendments

The anticipated costs and benefits of initially implementing the Audit Committee Rule and the Companion Policy were previously outlined in a paper entitled *Investor Confidence Initiatives: A Cost Benefit Analysis*, which was published on June 27, 2003. Given the limited nature of the Amendments, we did not consider it necessary to conduct a further cost benefit analysis.

Alternatives Considered

In developing the Amendments, no meaningful alternatives were considered.

[2] Immediate family member is defined in section 1.1 of the current Audit Committee Rule to mean an individual's spouse, parent, child, sibling, mother or father-in-law, son or daughter-in-law, brother or sister-in-law, and anyone (other than an employee of either the individual or the individual's immediate family member) who shares the individual's home.

Related Instruments

The Amendments and the Audit Committee Rule are related to National Instrument 51-102 *Continuous Disclosure Obligations,* National Instrument 71-102 *Continuous Disclosure and Other Exemptions Relating to Foreign Issuers*. The Amendments and the Audit Committee Rule are also related to the Governance Disclosure Rule and the Governance Policy.

Reliance on Unpublished Studies, Etc.

In developing the Amendments, we did not rely upon any significant unpublished study, report or other written materials.

Questions may be referred to the following people:

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Text of the Amendments

The text of the Amendments follows.

Date: April 15, 2005.

SCHEDULE A

List of Commenters

Canadian Tire Corporation, Limited
Canadian Bankers Association
Philippe Tardif

In the context of providing comments on proposed National Instrument 58-101 *Disclosure of Corporate Governance Practices* and proposed National Policy 58-201 *Corporate Governance Guidelines*, the following parties also provided comments relevant to the Amendments:

Canadian Tire Corporation, Limited
Ogilvy Renault
Power Corporation of Canada
Simon Romano

SCHEDULE B

Summary of Comments and Responses

No.	Topic	Comment	Response
1.	**Definition of Immediate Family Member**	Two commenters noted that the corresponding New York Stock Exchange (**NYSE**) definition of immediate family member was broader than "spouse, minor child or stepchild, or child or stepchild who shares a home with the individual", as used in clauses 1.4(3)(d) and 1.5(2)(a) of the amended Multilateral Instrument 52-110 *Audit Committees* (**Amended MI 52-110**).	Clause 1.4(3)(d) of Amended MI 52-110 provides that a member will be considered to have a material relationship with the issuer if certain of his or her family members have a relationship with the issuer's internal or external auditor. Although the scope of the relationship described in clause 1.4(3)(d) is narrower than that of the corresponding NYSE requirement, we believe that it identifies those relationships that would reasonably be expected to interfere with the exercise of a member's independent judgement without being inappropriately broad. However, issuers are reminded that notwithstanding the provisions of clause 1.4(3)(d), a member will only be independent if he or she does not have a direct or indirect material relationship with the issuer. The use of the narrower definition in clause 1.5(2)(a) is consistent with section (b)(1)(i) of SEC Rule 10A-3. Consequently, we have not revised this provision.
2.	**Compensation and Independent Chairs**	One commenter noted that subsection 1.4(7) of Amended MI 52-110 provides that individuals would not be considered to have a material relationship with the issuer solely because they had acted as a chair of the board on a part-time basis. However, the commenter was concerned that such an individual would still be considered to have a material relationship with the issuer if they received more than $75,000 in compensation for acting as the part-time chair during any 12 month period. Another commentor was of the view that an individual who would be considered to be independent if they were acting as a part-time chair or vice-chair should not be precluded from being considered independent if they act in that capacity on a full-time basis.	Subsection 1.4(6) of Amended MI 52-110 provides that direct compensation does not include remuneration for acting as a member of the board of directors or of any board committee. In our view, subsection 1.4(6) also encompasses remuneration for acting as a chair of the board or of any board committee. We have amended the companion policy to clarify this point. We disagree. In our view, it is more likely that an individual who acts as a part-time chair or vice-chair will be able to maintain their independence.

3.	**Independence and paragraph 1.5(1)(a)**	One commenter noted that the wording of clause 1.5(1)(a) of Amended MI 52-110 did not precisely correspond with the definition found in SEC Rule 10A-3. In particular, the commenter noted that clause 1.5(1)(a) applies to an individual "who has a relationship with the issuer pursuant to which the individual may accept, directly or indirectly, any consulting, advisory or other compensatory fee…". In contrast, section b(1)(ii) of SEC Rule 10A-3 provides that an individual "… may not… accept directly or indirectly any consulting, advisory or other compensatory fee from the issuer…" The commenter recommended that either the wording in clause 1.5(1)(a) of Amended MI 52-110 be revised or that we otherwise provide clarification that the intended approach as regards the acceptance of fees is the same as that adopted by the SEC.	We have revised clause 1.5(1)(a) to conform to section b(1)(ii) of SEC Rule 10A-3.
4.	**Application re parent and subsidiary**	Two commenters suggested that subsection 1.4(8) of Amended MI 52-110 was too far reaching. Subsection 1.4(8) provides that for the purpose of the independence tests in section 1.4, references to an issuer also include the parent and subsidiaries of the issuer.	We disagree. We note that the NYSE corporate governance rules contain a similar provision. We have, however, revised the "controlled company exemption" in subsection 3.3(2) to ensure its applicability.
5.	**French version**	One commenter noted that there was a discrepancy between the English version of clause 2.4(b) of Multilateral Instrument 52-110 *Audit Committees* and the French version.	This wording is consistent with the French legislative drafting rules. In the French version, the provision is drafted in a way that the word "and" is implied. As the French translation truly reflects the meaning of the English provision, no change has been made.