



**POWER FINANCIAL
CORPORATION**

NOTES FOR AN ADDRESS BY

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TO

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"Corporate Governance Regulation: Are We Missing The Mark?"

Hello Ladies and Gentlemen. It's my pleasure to have the opportunity to address you here today.

I want to share some thoughts with you today on the topic of Corporate Governance. More particularly, I want to share with you my concerns on where the governance regulations may be heading, and why I think policy in this area, as well intentioned as it may be, could prove to be a bad thing for many Canadian businesses.

Now worrying about Corporate Governance is not something that keeps a lot of people up at night.

In fact, some would say that if you are having trouble sleeping, reading a speech on Corporate Governance could be just the answer.

Let me put it this way – if you are at a cocktail party and you say “let me tell you my thoughts on Corporate Governance”, I guarantee you can have the whole plate of hors d'oeuvres in front of you, because the only person too polite to leave will be the waiter!

But I know there are also many who do care about the issue, including many in this room, and they understand its importance to Canadian business and competitiveness.

It's funny, because while many in the business community are not particularly interested in Corporate Governance, mention “Corporate Management”, and you are likely to get into a real debate. There are as many views on how best to manage a business as there are business people and business pundits.

What is the best way to manage a company? Which management style gets the most from its people? Which approaches have produced the best returns?

It's debated at universities. It's discussed in the business press. Go to the bookstore and there are rows and rows of books on it. The best seller list always seems to contain several books espousing the latest and greatest management theories. Consultants have built an industry around prophesizing about it.

So Corporate Management is an interesting topic, no – it's a hot topic.

But bring up Corporate Governance, and your listeners' eyes glaze over. And yet, the two are inextricably linked. They are two sides of the same coin. How a

company is managed is a direct reflection of how it is governed. Corporate Governance is just another way of saying – “oversight of management”.

One of the board’s prime roles, no doubt its most important role, is to oversee management on behalf of the shareholders. And how the board carries out this function, what the composition of the board is, how the board interacts with management - these are matters which have a very material impact on how the management will set its priorities and on how it will perform.

So I understand that it is more interesting to talk about management than it is to discuss governance, but given the link, it is just as important that we get the governance part right.

Now speaking about management, I think everybody instinctively understands and agrees that the manner in which a business is run has a huge impact on how well it performs.

And I think people also know there are many different ways to manage, and in fact that different management approaches work better in different situations. It’s such common sense that it almost seems trite to say it.

In fact, the diversity of management approaches is in itself a part of the business competitive landscape.

Businesses need to compete effectively, or they don’t survive.

It’s obvious to any consumer that companies compete on every dimension and facet of their business. They compete on technology, they compete on product features, they compete on better service models, they compete on quality standards, they compete on pricing, and they compete on distribution models. And on and on.

They also compete on their management approach. The management approach and effectiveness is a key competitive advantage or disadvantage for every business.

The part that is somewhat astonishing to me, therefore, given the direct link between corporate governance and corporate management, is that many groups that are active in corporate governance have seemingly ignored the need for diverse approaches and have instead prescribed a single “best in class” model as the standard for all companies to adopt.

That is certainly true of some in the press, which in some cases have adopted elaborate scorecards with point systems built on a single and detailed notion about what proper Corporate Governance looks like.

It's true of many of the investor groups that are active measuring and in many cases lobbying public companies about their governance practices. Many of these have also developed very prescriptive models.

And unfortunately it is also somewhat true of regulators, who have developed regulatory guidelines which prescribe many governance practices for public companies that seem to have been conceived with a narrow set of business circumstances in mind.

I'll give you some specific examples of what I mean in a few minutes, but let me first say that I think that the press, the investor groups and the regulators are right to be focused on Corporate Governance as an issue.

On the one hand, they are on the right issue because of the importance of Corporate Governance and its link to management and performance, as I have said.

And on the other hand, the abuses that have clearly existed in a fairly lengthy and well publicized list of corporate failures and scandals, such as the Enrons and Worldcoms, have meant that for the sake of the integrity and health of the capital markets, greater scrutiny on governance practices was inevitable and appropriate, and some action needed to be taken.

The problem is that the haste with which many of the resulting measures were developed following the scandals meant that they were not all well thought through.

The Sarbanes-Oxley legislation in the U.S. and the equivalent requirements in Canada and other countries are the most notable responses by authorities. The enormous cost of implementing and following these measures has left many wondering whether the additional level of control gained has been worth the effort. And it has left many in management and on boards feeling that a lot of time and energy is being spent making sure the boxes are ticked, rather than focusing on the underlying wellbeing of the business.

The various governance scorecards being used by many investor advocate groups or by the press are another case in point.

Most of the governance scorecards that I have seen provide a very detailed list of presumed governance best practices, and then score the issuer as to how it measures up. There is usually a single best practice in any functional area.

But my point is that there is not a single best way to govern businesses.

To think that the governance practices that are appropriate for a large widely-held public company, like a bank, could be the same as what might be best for

an up-and-coming technology company, or for say, an industrial company built and controlled by an entrepreneur, is quite simply misguided.

If one wanted to be generous about it, I suppose one could say that these are still early days in relation to these issues, and people are just beginning to think about how to promote higher standards of governance.

Analogous, one might say, to when we first learned how to paint in school. Painting by numbers was a great way to learn, but was rather confining to anyone who had aspirations of becoming a serious painter.

Painters need the freedom to create and be different, if they are going to distinguish themselves.

Governance advocates may still be at an early stage in their thinking, but a prescriptive "paint by numbers" approach is going to be very restrictive for many Canadian businesses, and hinder their ability to distinguish themselves.

The models being advocated by the investor groups and the press are of concern, but of even greater concern are some of the measures that have actually found their way into regulatory policy and guidelines.

We at our group, and I know many others, are particularly concerned by the approach taken by the Canadian Securities Administrators (CSA) in their "Corporate Governance Guidelines" issued in 2005. The issue of director independence has, in our view, not been well thought through.

The guidelines state that a majority of the members of a board of directors should be independent and that all members of the compensation committee and of the nominating committee should be independent. Very sound thinking and consistent with our own strong beliefs.

The problem is their definition of independent director, and the question of "independent from whom?" They have not only defined independence as "independent from management", which is as it should be, but have also said "independent from a major shareholder".

Now we have a problem.

A board should be made up of members who are primarily independent of management. If their primary role is to oversee management on behalf of the shareholders, it is difficult to see how one would be comfortable with them fulfilling this role if they were not.

But should a board be independent of the shareholders, or more specifically, a major shareholder? How does this make any sense?

Let me use our group as an example.

Power Financial's ownership stake in Great-West Lifeco was worth \$22 billion at yearend. It makes me feel better when I think about its value at yearend, by the way. It's of course down a bit since then, along with markets generally.

Officers of our company, including me, sit on the board of our subsidiary, Great-West Lifeco, as do others affiliated with our group. We have no other relationship with Great-West other than as directors and shareholders.

And let me tell you, we care how Great-West Lifeco does. We are major long term shareholders, and our interests are in seeing that the shareholders prosper over the long term.

One aspect of our model, and we think a key competitive advantage, is the fact that we can have a group of officers at our holding companies, namely Power Corporation and Power Financial, whose full-time job it is to focus and become knowledgeable about the affairs of the companies that we are invested in.

We take a long term approach to building shareholder value in these companies and through the boards and their committees, work very diligently to ensure that management is aligned with this objective.

And an important element of our model is control.

But our model is directly called into question by the current governance guidelines.

The guidelines, if followed, would prescribe that a majority of the board be independent of the major shareholder. A majority of the nominating committee would be independent of the major shareholder. The compensation committee, a key board committee with real influence over management, would likewise be majority independent. And the audit committee must be 100% independent of a major shareholder. The audit committee composition is an absolute requirement, not a guideline.

Advocates of the guidelines say that these are "only guidelines" and that companies with good reasons for not falling in line with them need only state the reasons in their statement of governance practices.

But this misses the point. It overlooks the important reputational issue that is created for companies like us.

Because the guidelines do not fit our model, we are made to appear to be "non-compliant" with the guidelines, and are required to explain ourselves. We believe

this gives an inappropriate impression to the marketplace. We find this troublesome given that we seek to meet the highest standards of governance practice.

The reality is that guidelines come to be regarded as “best practices”. In fact, shortly after they were published, the TSX referred to them explicitly as best practices.

Consequently, no amount of explanation in a company’s Statement of Corporate Governance Practices in its Management Proxy Circular can overcome the inference that it doesn’t comply with “best practices”.

And so the reputational impact spreads.

The governance ratings published by a major business paper assign a substantial weight to board and committee independence. The flawed definition of independence they use is essentially the same as the guidelines. Companies using our governance model are automatically marked down heavily.

The proxy advisory services have also picked up and run with the flawed definition. Over the last few proxy seasons, in several cases we are familiar with, we have seen it aggressively applied by one of the more widely circulated proxy voting advisory services.

As a result, companies are unfairly criticized for low independence levels on boards and board committees, when in fact their boards are overwhelmingly independent of management and committees entirely free from management representatives.

Perhaps you can imagine how incongruous this seems to us when the driving purpose of our carefully considered governance system is to deliver long-term value to all shareholders.

We are not alone in being affected by this flawed definition of independence. In fact over 70% of the top 500 non-financial public companies in Canada have a major shareholder, all of whom could be affected by the guidelines, and around 30% of companies with market caps above \$300 million have a shareholder with a 50% or greater control position.

The preponderance of companies with a major shareholder is an important attribute of the Canadian economy, to a greater extent than is the case in the U.S. And yet legislation in both the U.S. and in the U.K. exempts companies with controlling shareholders from their independent director requirements.

It's ironic that our regulators, who have sought to align our regulatory regimes with those of the U.S. have chosen not to emulate this specific U.S. provision given its particular relevance to Canada.

I could and will argue that these rules run contrary to the fundamental rights of shareholders. If you own a majority of the shares of a company you should be able to control the company.

In fact, we would expect that when investors buy shares in the companies that we control, they are aware of our ownership and many may have indeed invested because of our presence.

But I don't have to go that far to make the case. Because the guidelines would prevent the use of an extremely effective method of governance for a large swath of Canadian companies, and that in and of itself should be sufficient to re-think them.

There are some who would say that the definition of independence in the CSA guidelines was not an oversight at all, but was in fact intended to force companies which have a majority shareholder to have boards with a majority of directors independent of them.

The rationale is that a majority shareholder can take advantage of minority shareholders by engaging in transactions that are not in their interest. The transactions and dealings that were the subject of the Hollinger-related trials would be cited as an example.

I think that the question of "self-dealing" is a legitimate issue for people to be concerned with, but the solution is not to try to weaken the rights of ownership. Not when there are more tailored and effective methods of guarding against abuses.

Within the Power group, we have thought a lot about this issue. We have adopted measures that deal with the potential abuse of "self-dealing" head on, and we think they could be a model for other companies with a major shareholder to follow. In fact, they could be an alternative model for securities regulators to consider in controlled company situations.

All of our public companies have formed "Related Party and Conduct Review Committees" whose mandate it is to review and approve transactions, if there are any, between the company and its major shareholder or an affiliate of the major shareholder.

These committees are made up of directors who are independent of the majority shareholder, just like the definition that exists in the CSA guidelines.

A real life example within our group might be if our two subsidiaries, Great-West Life and Investors Group decided to share the purchase of a piece of software so that they both get better terms and save money. The Related Party committees would review the terms of such an arrangement on behalf of each company.

You might say this is a pretty innocuous transaction between the two companies, but because each of Great-West Life and Investors Group, through its public parent IGM, are controlled by Power Financial and each has separate minority shareholders, we think fully independent directors should review the arrangement.

We have worked with Related Party Committees for many years within our insurance companies, initially because they are prescribed by insurance regulation.

In effect, what we are saying, is that for most governance matters, independence should be defined as "independent of management", not of a major shareholder. But if the major shareholder, or its affiliate, has an interest in a matter that is different than other shareholders, then the matter should be subject to review by directors who are independent of the major shareholder.

And in our group, we have set up board structures and processes to make this work.

We think the concept is effective, and we have expanded it to all of our public companies.

I am sure one could develop other methods of addressing potential conflicts between a company and a major shareholder, but the use of standing independent Related Party Committees is simple and very effective.

Let me raise a potential unforeseen consequence of the guidelines.

Before I do, let me say that our group cares about Corporate Governance, not just as an issuer, but as a major investor.

Between their own balance sheet investments and the investments managed as part of their mutual funds and other managed assets, the companies in the Power group manage over \$500 billion of financial assets.

If we, who are already public, find the guidelines restrictive, how will entrepreneurs who may be thinking of going public react to them?

How are public markets going to compete with private equity, for example, if public markets don't allow for an effective controlled company model? As you

know, the private equity players typically rely on a control model to carry out their business plans.

Now private equity certainly has its place in capital markets, and can be a positive force for change in a company. As you may know, Power Corporation is active in private equity.

But there can be some negatives associated with private equity. The typical short three to five year investment horizon and the lack of participation by individual investors are two of them. As a matter of public policy, we should be concerned if an increasing number of Canadian companies turned away from public markets and migrated to private equity, simply because we had not been able to devise a system that allowed for controlled public companies with proper safeguards for public minority shareholders.

When it published its Corporate Governance Guidelines in 2005, the Canadian Securities Administrators had given itself one year to study and re-examine the reservations expressed by numerous groups, including ours, about the consequences that the guidelines could have on controlled companies.

The CSA are still considering the definition of an independent director in the case of a controlled public company. We are pleased that they have chosen to take the time needed to properly consider this key issue.

Well there you have it – some fairly simple and straight-forward thoughts about Corporate Governance regulation.

I doubt that I have shaken you to the point where you won't be able to sleep tonight worrying about this issue.

But I do hope that I have impressed upon you that this is actually a pretty important issue for Canadian regulators to get right.

If they don't, a large number of Canadian businesses and the capital markets themselves will be impacted, in my view, in a negative manner.

Ladies and Gentlemen, I would like to thank the Empire Club of Canada for inviting me here today, and I would like to thank you for your kind attention.

Thank you.