

Board Shareholder Confidence Index

Our corporate governance research focuses on Boards of Directors, social networks, and corporate performance. The reports produced by the Clarkson Centre for Business Ethics & Board Effectiveness (CCBE) are timely, reliable, actionable, and comprehensive.

Developed in spring 2003, the Board Shareholder Confidence Index comprises factors used by active shareholders to assess Boards of Directors for corporate governance best practices. While other variables can contribute to Board effectiveness – including those elements best observed from inside the boardroom – we capture those factors that influence shareholders’ confidence in a Board’s ability to fulfill their duties. These also differ from the TSX Guidelines for effective corporate governance in their focus upon the shareholders’ perception of risk.

We evaluate and rank Boards of Directors by their potential to act effectively and by their performance as indicated by past practices. The score is developed using four linked steps and the result is a transparent, objective, and adaptable rating system which assigns companies listed on the S&P/TSX Composite Index an [overall score](#) from AAA+ [highest] to C [lowest]. [Click here for Current Scores](#)

NEW FOR 2007 – Interlock criteria, Director stock ownership criteria, Nominating Committee independence, “CEO pay is related to performance” replaces “CEO Compensation Increases while Share Price Decreases”, and outstanding loan criteria.

GLOSSARY OF TERMS

1. Individual Potential

In order for shareholders’ interests to be fully represented by the Board of Directors, individual Directors must be able to act independently from the interests of management, and independently from the other Directors as well. Stock ownership indicates that a Director’s interest is aligned with that of shareholders, thereby providing motivation for Directors to improve company performance. Individual Potential comprises these two factors: [Director Independence](#) and [Director Stock Ownership](#).

2. Group Potential

Group Potential represents the potential for the Board as a whole to best represent the interests of shareholders without compromising the Individual Potential of the Directors. The factors determining Group Potential are [Board Meeting Structure](#), and the implementation of [Board Evaluation Processes](#).

3. Past Practices

Past practices are assessed by evaluating the results of Board decisions. Scoring is based on practices that investor surveys generally regard as being opposed to the best interests of shareholders, including:

- Excessive option grants, and/or dilution
- Option re-pricing
- No link between CEO pay and company performance
- Director Pensions
- Outstanding loans to Directors or executives
- Evergreen option plans

SCORING CRITERIA

1(a) Director Independence

i. Independence

Director Independence measures the independence of individual Directors from one another, as well as from company management.

Relationships with management increase the potential risk that a Director will put executive interests before those of the shareholder. If a Director meets any of the following criteria, she/he is considered related to management:

- Employee of the company or a related company (currently or within three years)
- Executive of any affiliated company
- Director or Director's firm has provided legal, auditing, or consulting services to the company (within the last 3 years)
- Kinship to CEO
- Any other relationship deemed material by CCBE which does not fall under the above categories.

At least two-thirds of the Board must be independent from management or else a deduction is made. The deduction increases as the proportion of related Directors increases.

Scoring

% Independence	Deduction
Less than 30%	-15
30% - 50%	-10
50% - 60%	-5
60% - 66.7%	-3
Over 66.7%	No deduction.

ii. Interlocks

It is also important that relationships between Directors be kept to a minimum. If two Directors sit on more than one Board together, this is referred to as a "Director Interlock" and there becomes a perceived risk of decisions being made in the interests of another company. A deduction is made if more than one Director Interlock is present on a Board. Scoring in this area has previously only recognized interlocks between those companies listed on the S&P/TSX Composite Index, however the scope has been broadened in 2007 to consider all other publicly traded companies upon which Directors serve.

Scoring

# Interlocks	Deduction
>1 Interlock	-5
1 or 0 Interlocks	No Deduction

iii. Excessive Board Memberships

In order to perform effectively, a Director must not have too many obligations beyond her/his duties on the Board. A Company receives a deduction for every Director who is a member of more than five S&P/TSX Boards.

Scoring

# S&P/ TSX Boards	Deduction
>5 Boards	-5 (per Director)
Otherwise	No Deduction

Overall Independence Letter Grades

Total Deductions	Grade
No Deduction	AAA
-3	AA
-5	A
-8	B
More than -10	C

1(b) Stock Ownership

A Director, however independent and experienced, requires motivation to act in the best interest of shareholders. This motivation is measured as a function of a Director's stock ownership in the company.

For each company, our calculation is based on the average holdings of the third of Directors with the fewest holdings, relative to the Directors' annual retainer value. In cases where Directors receive no compensation other than options, ownership is scored on a graded scale. Annual retainer figures include any annual deferred share unit grants, valued using the company's year-end share price if a grant date is not given. Directors with less than three years' tenure on the Board are excluded from this calculation.

When an annual retainer is awarded:

$$\text{STOCK OWNERSHIP MULTIPLE} = \frac{\$(\text{AVERAGE SHARE OWNERSHIP OF BOTTOM THIRD OF DIRECTORS})}{\$(\text{ANNUAL RETAINER})}$$

In cases where Directors receive an annual retainer, a deduction is made when the stock ownership multiple is less than four. When there is no retainer, a deduction occurs when the average ownership is less than \$30,000. The deduction increases as the share ownership decreases.

Overall Ownership Scoring and Letter Grades

When a retainer is awarded:

Ownership Multiple	Deduction	Grade
4 or more	No deduction	AAA
3-4	-3	AA
2-3	-5	A
1-2	-10	B
<1	-15	C

When no retainer is awarded:

Average Share Ownership	Deduction	Grade
\$30,000 or more	No deduction	AAA
\$25,000 to \$29,999	-3	AA
\$20,000 to \$24,999	-5	A
\$10,000 to \$19,999	-10	B
Less than \$10,000	-15	C

2(a) Structure

A company's score in this category is based on the characteristics of its Board meeting structure. The structure of a Board and its meetings can encourage or impede the [Individual Potential](#) of its Directors, as well as affect the Board's output. Structural measurements include:

- i) The separation of CEO and Chair positions
- ii) Independence of Audit, Compensation and Nominating Committee members
- iii) The ratio of voting rights to share ownership between share classes.

i. CEO/Chair Split

The perceived potential for the Board to operate independently from management is decreased if the CEO and Chair positions are not separated and therefore a deduction is made if this is the case. A smaller deduction is given to companies with no CEO/Chair split but that have appointed an Independent Lead Director to lead Board meetings, and to companies with split CEO and Chair positions, but a related Chair.

Scoring

Split?	Deduction
No CEO/Chair Split	-10
Split / Chair is Related	-7
No Split / Lead Director Appointed	-5
Split / Related Chair / Lead Director Appointed	-5
Otherwise	No Deduction

ii. Committee Independence

Full-independence of a company's committees is necessary to ensure that executive compensation, company accounting and board nominations are handled with no conflicts of interest between management and shareholders.

Deductions are made if a dependent Director (as determined in the Director Independence section) is a member of the Audit or Compensation committees. A deduction will also be made if more than one dependent Director is a member of the Nominating committee. (Note that executives of Parent Companies are considered unrelated on the Compensation and Nominating Committees.)

If an interlock exists between two executives on the Compensation Committees of each others' companies, the involved Directors are considered related with respect to these Compensation Committees. This is to discourage situations where executives from different companies are determining each other's salaries.

Additional restrictions are placed on committee membership: deductions are also made if any Related-Independent Directors sit on the Audit or Compensation Committees. The criteria for Related-Independence includes:

- Non-Management major shareholder (>30% votes)
- Kinship to or significant business relationship with non-management major shareholder of company of interest

Each committee is scored separately.

Scoring

Committee Independence	Deduction
Related Director(s) on Audit Committee	-10
Related Director(s) on Compensation Committee	-10
2 or more Related Directors on the Nominating Committee	-10
Full Committee Independence	No Deduction

iii. Share Structure

Many companies have several classes of shares, and often the different classes do not have equal voting rights. An imbalance of voting rights decreases shareholder influence on Board decisions.

EXAMPLE:

Class	Votes per Share	Shares Outstanding
Class A Voting	1	10,000
Class B Non-Voting	0	5,000,000

In this case, all the company's voting rights are associated with a small minority of the outstanding shares.

Deductions in this area are graduated— as the disproportion between shares and voting rights increases, so does the deduction. No deduction is made for companies whose multiple share classes are allowed the same number of votes per share.

Scoring

Share Structure	Deduction
• <20% of Equity Controls >80% of Votes	-30
• 40% or Less Equity Controls 60% or More Votes	-20
• <50% of Equity controls >50% of Votes	-15
• >50% of Equity controls >50% of Votes	No Deduction
• No Dual Class or Subordinated Share Structure	No Deduction

Overall Structure Letter Grades

Total Deduction	Letter Grade
No Deduction	AAA
-5	AA
-10	A
-20	B
-25 or greater	C

2(b) Systems (Evaluations)

In order to receive a perfect score in this category, a company must implement regular and formal evaluation processes for the Board as a whole and for each of its individual Directors. Scoring is based on disclosure of the evaluation processes; if the fact of these evaluations is mentioned but with no details as to processes, a deduction is still made. Full-Board and individual Director evaluations are scored separately.

Scoring

Systems	Deduction
No Full-Board Evaluation	-10
No Individual Director Evaluation	-5
Otherwise	No Deduction

Overall Systems Letter Grades

Total Deduction	Grade
No Deduction	AAA
-5	AA
-10	A
-15	B

3(a) Board Decision Output (Past Practices)

i. Dilution

Dilution occurs when options granted to executives and Directors represent a significant proportion of the outstanding shares, thus diluting returns that would otherwise go to shareholders. A deduction is made if options represent more than 10% of a company's outstanding shares. A deduction is also made if options granted to the CEO are more than 5% of a company's outstanding shares. These are both thresholds set by the TSX.

Scoring

Dilution	Deduction
CEO Options >5%	-5
Company Options >10%	-10
Otherwise	No Deduction

ii. Option Re-pricing

When a company's share performance has suffered, the cost of exercising stock options can be greater than the cost of purchasing stock at market value. In such a case, a company may decide to lower the exercise price in order to align it with the market value of the stock. Option re-pricing is perceived as relieving Directors of their responsibility for the company's performance. A deduction is made if a company has re-priced their options within the last three years.

Scoring

Dilution	Deduction
Options Re-priced Within 3 Years	-20
Otherwise	No deduction

iii. CEO Pay is Related to Performance

It is the responsibility of the Board of Directors to determine CEO compensation, and in order to best represent the interests of a company's shareholders, such compensation should be associated with the company's performance. A deduction is made here if there is no explicitly disclosed link between the company's financial performance and the determination of the CEO's bonus. The nature of the link must be specifically given (i.e. a description of bonus criteria must be provided).

Scoring

Bonus Disclosure	Deduction
CEO bonus not explicitly linked to company performance	-15
Otherwise	No deduction

iv. Evergreen Option Plan

Generally, shareholders must approve the replenishment of a company's option plan once a specific number of options have been issued. Many companies are now introducing Evergreen Option Plans, however, through which the maximum number of options approved for issue stands as a percentage of outstanding shares rather than a specific number. These plans allow companies to continue granting options in any amount up to a certain percentage dilution. Evergreen plans remove authority from shareholders, while increasing the possibility of higher dilution.

Scoring

Evergreen Option Plan	Deduction
Company has Evergreen Option Plan	-5
Otherwise	No deduction

v. Outstanding Loans to Directors or Executives

Although most companies have discontinued granting loans to their Directors and executives, many still have outstanding loans on their books, and some still have yet to discontinue granting loans. We regard loans to employees as an inappropriate use of shareholder money. Financial institutions granting loans at consumer rates will be exempt from deductions here.

Scoring

Loans to Executives or Directors	Deduction
Company has outstanding interest-free loans	-15
Company has outstanding interest-bearing loans	-10
Company has loans outstanding, but has discontinued granting loans.	-5
No outstanding loans	No deduction

vi. Director Pensions

Some boards offer their Directors Pension Plans, which we view as creating an unnecessary tie between the Directors and the corporation. Director pensions increase the likelihood that a conflict of interest could compromise Directors' responsibilities to shareholders.

Scoring

Director Pensions	Deduction
Directors receive pensions	-10
Directors do not receive pensions	No deduction

Overall Output Letter Grades

Total Deduction	Grade
No Deduction	AAA
-5	AA
-10	A
-20	B
-30	C

Total Scores

Each company begins with 100 points from which [Individual Potential](#), [Group Potential](#), and [Past Practices](#) deductions are made. Total letter grades are determined as follows:

Overall Score	Grade
100	AAA+
95	AAA
90	AA
75	A
50	B
<50	C