

## **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 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 2009 – Director Share Ownership Increase, Director Skills Matrix, Meeting Attendance, Continuing Education Disclosure, Majority Voting, New CEO Hired Externally and CEO Succession Plan Disclosure.**

## **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](#), the implementation of [Board Evaluation Processes](#), use of a [Board Skills Matrix](#) to manage board composition, [Director Meeting Attendance](#) and [disclosure of continuing education opportunities](#) available to directors.

### **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](#)
- [Majority Voting in Director Elections](#)
- [CEO Succession Practice and Disclosure](#)

**SCORING CRITERIA**

**1. INDIVIDUAL POTENTIAL**

**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**

<b>% Independence</b>	<b>Deduction</b>
<b>Less than 30%</b>	<b>-15</b>
<b>30% - 49.9%</b>	<b>-10</b>
<b>50% - 59.9%</b>	<b>-5</b>
<b>60% - 66.6%</b>	<b>-3</b>
<b>66.7% or more</b>	<b>No deduction.</b>

**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 since 2007 to consider all other publicly traded companies upon which Directors serve.

**Scoring**

<b># Interlocks</b>	<b>Deduction</b>
<b>&gt;1 Interlock</b>	<b>-5</b>
<b>1 or 0 Interlocks</b>	<b>No Deduction</b>

**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 Composite Index 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**

**i. Director 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 who have been directors for at least 3 years 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. Previously, the value of the annual retainer was calculated as the sum of the stated annual retainer and the grant date value of any share or share unit awards. As of 2009, the value of the annual retainer is calculated as the sum of all annual cash amounts, the grant date value of all share and share unit awards and the disclosed fair value of any option grants. Committee member fees, chair retainers and attendance fees are excluded.

When an annual retainer is awarded:

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

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 graduated deduction increases as the share ownership decreases.

**Director Ownership Scoring**

**When a retainer is awarded:**

Ownership Multiple	Deduction
4 or more	No deduction
3-4	-3
2-3	-5
1-2	-10
<1	-15

**When no retainer is awarded:**

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

**ii. Director Ownership Increase**

Shareholders may feel more confident if they see that the directors are growing their own investments. Further, it is in the company’s best interest to have a program in place that requires directors to continue to hold a growing stake. In order to track the continued reinvestment of directors, CCBE looks at whether or not each director who stood for election at the past annual general meeting, and is also a nominee at the upcoming annual general meeting, has increased their total holdings in the company since the previous management information circular. A deduction is made for each director whose holdings do not increase up to a maximum of five directors.

Total holdings of an individual director are calculated as:

$$\text{NUMBER OF SHARES} + \text{NUMBER OF DEFERRED SHARE UNITS} = \text{TOTAL HOLDINGS}$$

An exception is also made for any director who controls at least 5% of the company.

**Scoring**

Director Ownership Increase	Deduction
Director did not increase holdings	-1 (per director)
All directors increased holdings	No deduction

**Overall Stock Ownership Letter Grades**

Total Deductions	Grade
No deduction	AAA
-1	AA
-3	A
-10	B
-15 or lower	C

## 2. GROUP POTENTIAL

### 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	-15
Split / Chair is Related	-10
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 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	-20
• 40% or Less Equity Controls 60% or More Votes	-15
• <50% of Equity controls >50% of Votes	-10
• >50% of Equity controls >50% of Votes	No Deduction
• No Dual Class or Subordinated Share Structure	No Deduction

**Overall Structure Letter Grades**

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

## 2(b) Systems

### i. Evaluation Processes

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**

<b>Evaluation Processes</b>	<b>Deduction</b>
<b>No Full-Board Evaluation</b>	<b>-10</b>
<b>No Individual Director Evaluation</b>	<b>-10</b>
<b>Otherwise</b>	<b>No Deduction</b>

### ii. Skills Matrix

The annual management information circular is the primary resource for educating the shareholders regarding the directors standing for election. Including a skills matrix in the circular illustrates for shareholders how each director fits the needs of the board and highlights the skills that each director provides. Use of a skills matrix also provides a framework for boards to identify gaps and redundancies in board composition.

A deduction is made if the individual skills of each director are not listed and if the skill set or requirements of the board as a whole are not disclosed.

**Scoring**

<b>Skills Matrix</b>	<b>Deduction</b>
<b>Full Disclosure of director and board skills</b>	<b>No Deduction</b>
<b>Disclosure of board skills but no director skills</b>	<b>-1</b>
<b>Disclosure of director skills but no board skills</b>	<b>-2</b>
<b>No disclosure of board or director skills</b>	<b>-3</b>



**iii. Continuing Education for Directors**

By providing formal continuing education opportunities to directors, boards can ensure that all of their directors have training in all areas relevant to the board’s oversight of the company. Such opportunities may include training manuals, site visits, courses and retreats – however, many companies have creative and unique approaches.

In order to get full marks, companies must disclose both the formal education process as well as the specifics of what was done in the most recent year.

**Scoring**

<b>Director Education</b>	<b>Deduction</b>
No disclosure of continuing education process or most recent events	-3
Disclosure of continuing education process but no disclosure of most recent continuing education events	-2
Disclosure of most recent continuing education events but no disclosure of formal process	-1
Full disclosure of continuing education process and most recent continuing education events	No Deduction

**Overall Systems Letter Grades**

<b>Total Deduction</b>	<b>Grade</b>
No Deduction	AAA
-1	AA
-3	A
-10	B
-20 or greater	C

## 2(c) Director Attendance

Poor director attendance can be an indicator that a director is overcommitted and unable to dedicate sufficient time to board matters. If a director is incapable of committing to his/her board responsibilities, the board must review that director’s membership.

A deduction is made if a director standing for re-election failed to attend at least ¾ of board or individual committee meetings.

### Scoring

Meeting Attendance	Deduction
All directors attended at least 75% of all meetings	No Deduction
At least 1 director attended < 75% of meetings but is not being re-elected	No Deduction
At least 1 director attended <75% of meetings and is standing for re-election	-2

### Overall Director Attendance Letter Grades

Total Deduction	Grade
No Deduction	AAA
-2	B

## 3. BOARD DECISION OUTPUT (PAST PRACTICES)

### 3(a) Compensation

#### 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 issued and outstanding represent more than 10% of a company’s outstanding shares.

### Scoring

Dilution	Deduction
Company Options >10%	-10
Company Options >5%	-5
Company Options <5%	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**

<b>Dilution</b>	<b>Deduction</b>
<b>Options Re-priced Within 3 Years</b>	<b>-20</b>
<b>Otherwise</b>	<b>No deduction</b>

**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 explicit link between the company’s financial performance and the determination of the CEO’s bonus.

**Scoring**

<b>Bonus Disclosure</b>	<b>Deduction</b>
<b>No financial performance connected to CEO bonus</b>	<b>-15</b>
<b>Otherwise</b>	<b>No deduction</b>

**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**

<b>Evergreen Option Plan</b>	<b>Deduction</b>
<b>Company has Evergreen Option Plan</b>	<b>-5</b>
<b>Otherwise</b>	<b>No deduction</b>

**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. Companies that are financial institutions and grant loans to executives and Directors at consumer rates receive no deduction for this, however, as these companies are in the business of granting loans and it is not in the company’s best interest for these individuals to obtain loans from competitors.

**Scoring**

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

**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**

<b>Director Pensions</b>	<b>Deduction</b>
<b>Directors receive pensions</b>	<b>-10</b>
<b>Directors do not receive pensions</b>	<b>No deduction</b>

**Overall Compensation Letter Grades**

<b>Total Deduction</b>	<b>Grade</b>
<b>No Deduction</b>	<b>AAA</b>
<b>-5</b>	<b>AA</b>
<b>-10</b>	<b>A</b>
<b>-20</b>	<b>B</b>
<b>-30</b>	<b>C</b>

### 3(b) Director Elections (Majority Voting)

Until recently, director elections in Canada were solely based on a plurality vote whereby shareholders are given only the option to vote ‘for’ or ‘withhold’ from voting. In these cases, a single vote ‘for’ a director results in his/her election. Majority voting systems are now being adopted by many Canadian firms, whereby a director is only elected if a majority of votes are cast ‘for’ his/her election. If a majority of votes are cast ‘against’ the director, he/she will immediately submit their resignation to be considered by the board.

A deduction is made for if there is no majority voting policy in place.

#### Scoring

Majority Voting	Deduction
Majority Voting policy in place	No deduction
No Majority Voting	-5

#### Overall Director Elections Letter Grades

Total Deduction	Grade
No Deduction	AAA
-5	B

### 3(c) CEO Succession

#### i. Succession Plan Disclosure

One of the Board’s most important responsibilities is ensuring that a proper succession plan is in place in the event that the CEO ceases to hold his position. Without a formal and reliable succession plan for the CEO, the company is exposed to significant risk, often accompanied by the significant cost of hiring externally. Disclosure of a formal succession plan for the CEO in the Information Circular reassures shareholders that these risks are being considered.

A deduction is made if there is no disclosure of a formal succession planning process.

#### Scoring

Succession Plan Disclosure	Deduction
Formal Succession Plan process disclosed	No deduction
No formal succession plan process	-1

**ii. New CEO Hired Externally**

Hiring a new CEO from outside of the company can be an indication of poor succession planning. If a board has implemented a rigorous succession planning process, the best candidates will in most cases be identified internally. In addition, external hiring is often significantly more expensive than hiring from within.

A deduction is made if a new CEO has been hired and he comes from an unrelated company.

**Scoring**

Succession Plan Disclosure	Deduction
No new CEO or new CEO hired internally	No deduction
New CEO hired externally	-5

**Overall CEO Succession Letter Grades**

Total Deduction	Grade
No Deduction	AAA
-1	A
-5	B
-6	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