July 22, 2011

European Directorate General Internal Market and Services /
Company Law
Corporate Governance and Financial Crime Unit
European Commission
SPA2 03/103
1049 Brussels, Belgium

Re: Green Paper
The EU corporate governance framework

(File Number COM(2011) 164)

VIA COURIER AND ELECTRONIC SUBMISSION: markt-complaw@ec.europa.eu

Dear Commission Members:

Thank you for establishing a high-level governance forum for discussions and debates and for the exchange of experiences. We welcome this opportunity to promote and encourage increasingly high standards of governance. The need for a clear road map through the shifting and confusing terrain of corporate governance is very compelling. In a global marketplace, the solutions and recommendations championed in Europe will have a profound effect on governance standards in Canada and elsewhere.

By way of background, we are a collaborative working group of eight Canadian citizens who have come together for the purpose of this joint submission. We are independent scholars and practitioners whose skills, knowledge, experience, education, research and training include the following domains/sub-domains: accounting, auditing, board effectiveness, business ethics, conflicts of interest, corporate governance, diversity, executive compensation, financial services, investment banking, legal services, the mutual fund industry, proxy advisory firms, and risk management.

We address twenty-three (23) of the twenty-five (25) questions within the Green Paper below. Our comments focus upon the following topics and questions:

The Governance of SMEs and Unlisted Companies:

- Adapting EU corporate governance measures to company size; and measures for unlisted companies (Questions 1 and 2);

Board Recruitment: Leadership, Skills and Diversity:

- Division of function and duties of the board chair and CEO; and director recruitment (Questions 3 and 4);

Board Diversity:

- Diversity policy, and gender balance on boards (Questions 5 and 6);

Individual Director and Board Effectiveness:

- Mandate limitation of non-executive directors (NEDs), and external board evaluation (Questions 7 and 8);

The Governance of Remuneration:

- Remuneration policy and report, and remuneration of directors; and shareholder vote on remuneration policy and report (Questions 9 and 10);

The Governance of Risk:

- Board oversight and disclosure of 'risk appetite,' including societal risks; and effective risk management arrangements commensurate with risk appetite (Questions 11 and 12);

The Governance of Asset Managers:

- Performance evaluation and incentive structures; monitoring; and independence and disclosure and management of conflicts of interest (Questions 14, 15 and 16);

The Governance of Proxy Advisors:

- Transparency of, and restrictions upon, proxy advisors (Questions 18 and 19);

Shareholder Engagement:

- Shareholder identification, dialogue and cooperation (Question 20);

Interests of Minority Shareholders:

- Additional rights in companies with controlling/dominant shareholders, and protection of minority shareholders in respect of related party transactions (Questions 21 and 22);

Employee Share Ownership:

- Promoting EU level employee share ownership (Question 23); and

Governance Code Monitoring and Implementation:

- Explanations for departures, and description of alternative solutions; and assessment of information quality and explanations by monitoring bodies (Questions 24 and 25).

Canadian Corporate Governance Practices and Our Group's Submission

Canada has adopted the Anglo-American, unitary model of corporate governance. Our companies, however, operate within different ownership structures, legal and linguistic dualities, geographic diversity, and a decentralized regulatory regime of thirteen provinces and territories. We have companies that are state-owned, family, significant shareholder, small and medium-sized listed, as well as widely held, not dissimilar to the diverse plurality and tapestry within the European Union.

Canada has had formal corporate governance guidelines in place since 1994 within a flexible "comply or explain" approach. There has been time to digest and assess a continuously evolving corporate governance landscape, as companies and boards adopt guidelines and practices to suit the foregoing diverse circumstances, in a flexible manner.

The Canadian corporate governance guidelines, most recently revised in 2005, have been adopted and adapted by companies within the listed sector, and through osmosis and other best practices, within private, governmental and not-for-profit sectors as well. It is upon this experience that we draw within this submission.

Members of this group have advised and worked with boards, regulators, and companies that have become recognized for their leading governance practices. It is these experiences upon which we also draw.

The writing expressed herein is our own and should not be attributed to any organization or jurisdiction with which any of us is or may be affiliated (including corporate and regulatory examples provided herein upon which we draw). Brief biographies and affiliations are noted at the conclusion for background and identification purposes only.

We are pleased to take part in this public consultation process and trust our input will be useful to the Commission and its deliberations. If you have any questions or comments regarding this submission, please contact our project lead and corresponding author, Professor Richard Leblanc, York University, 4700 Keele Street, Toronto CANADA M3J 1P3, email rleblanc@yorku.ca, tel. +1 (416) 736-2100 ext. 33744, or any of us individually at our respective coordinates.

Sincerely,

Working Group on EU Green Paper: The EU corporate governance framework

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Table of Contents

General questions

(1) Should EU corporate governance measures take into account the size of listed companies? How? Should a differentiated and proportionate regime for small and medium-sized listed companies be established? If so, are there any appropriate definitions or thresholds? If so, please suggest ways of adapting them for SMEs where appropriate when answering the questions below.

Inevitably, good governance will look somewhat different depending on a company's scale and dimensions. But, a diminutive corporate size, we maintain, is not a suitable reason to relax or diminish the principles of good governance. There is a compelling business case to be made for smaller companies to adopt good governance principles and to adhere to – or aspire to – lofty governance standards as a goal.[1] The need to create standards and behaviours that add value by adopting good governance principles is as important for small and medium-sized enterprises (SMEs), we argue, as for larger enterprises.

(For the purposes of this discussion, we use the definition of SME adopted in 2008 by the Department of Business, Innovation and Skills in the UK. BIS defines a small business as one employing fewer than 50 people. A medium-sized company employs between 51 and 250 employees. Within these two brackets, there is considerable diversity – from small owner-manager company, to small, dynamic technology companies with significant growth potential, to family-owned and family-operated businesses, to relatively mature companies that are approaching in various dimensions the larger listed-company model.)

For one thing, SMEs, although overshadowed in the business press and in the public consciousness by larger market-cap companies, are in many ways the lifeblood of most economies and markets in Europe, in North America and elsewhere. To state the obvious, SMEs are, in many cases, the next generation of large market-cap enterprises. As larger enterprises, these companies and their governance practices will increasingly come under the microscope and be subjected to the heightened scrutiny by shareholder activists. If SMEs had not begun with a proper corporate governance culture, it becomes more difficult to overcome this as they grow.

Second, all SMEs operate in the same legal and regulatory framework as larger listed or unlisted companies. The characteristics of this framework include:

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[1] King III, for example, applies to "all entities regardless of the manner and form of incorporation or establishment and whether in the public, private sectors or non-profit sectors. We have drafted principles so that every entity can apply them and, in doing so, achieve good governance." See page 16 of "King Code of Governance Principles for South Africa 2009" (Institute of Directors Southern Africa, effective March 2010). The King III Code and Report have comprehensive principles and cascading practices that companies can choose to adopt, to achieve the objectives of the principles, based on a "comply or explain" approach. The key to comprehensiveness and providing choice and flexibility for companies is in the drafting of principles and, in particular, the recommended practices. The UK Code (2010) also does a good job of this (through cascading main principles, supporting principles and code provisions), although the drafting of King III, in respect of its flexibility to small and mid-cap and private companies, is exemplar, in our view.

i. Separate legal status independent from its shareholders;
ii. A constitution comprising (among other things) by-laws;
iii. A code of directors' duties including a requirement to promote the success of the company for the benefit of its members as a whole;
iv. Legal and common law provisions relating to health and safety, the environment, employment and tax;
v. Maintaining proper records including books of account and financial statements; and
vi. Filing annual returns with company regulators.

Corporate theorists – at least the modern ones – will dissect a corporate enterprise, regardless of size, into a varied assemblage of stakeholders including, among others, employees, creditors, suppliers, community groups, etc. Given the similar legal and regulatory frameworks, SMEs should, in our view, be subjected to the same governance standards as those for larger companies.

Third, at the risk of making an overly broad generalization, SMEs are more likely to suffer from a lack of governance infrastructure, a lack of financial sophistication, and an absence of experienced and disciplined board members. Investors in SMEs cannot rely on the institutional activists such as Institutional Shareholder Services Inc. (ISS) – who police rigorously the marketplace of larger enterprises to ensure proper disclosure, adequate financial controls, and anti-fraud and anti-corruption protections – to be vigilant and to monitor the periodic filings of SMEs. Maintaining strong governance requirements remains, therefore, part of the essential investor protection for investors in SMEs.

The Securities and Exchange Commission (SEC) has facilitated the offering process for large market-cap offerors – referred to as WKSIs or well-known seasoned issuers – by issuing Rule 405 under the *Securities Act of 1933* for companies with a market cap generally in excess of US$700m. Interestingly, the governance provisions of the *Sarbanes-Oxley Act of 2002* or the *Dodd-Frank Wall Street Reform & Consumer Protection Act of 2010* have not been relaxed by the SEC in favour of WKSIs or any other high-quality issuers. In fact, the internal control over financial reporting set out in Rule 404 of the *Sarbanes-Oxley Act* and the requirement of preparing and filing attestation reports have proven to be expensive and burdensome for issuers of all sizes to comply with – although, declining recently relative to revenues – and have driven a significant number of New York Stock Exchange registrants – large and small – to de-register from the Exchange.

Faced with questionable investment opportunities such as Sino-Forest Corporation (a commercial forest plantation operator in China), investors, in our view, need the support and protection offered by tough governance provisions. Core governance principles are essential to the integrity of and public confidence in the capital markets; so much so that they must, in our view, be applied uniformly to all listed companies – including SMEs.

One countervailing argument in favour of a differentiated corporate governance regime is the disproportionate financial burden faced by smaller companies on designing and implementing suitable governance practices. The issue is one of fairness. Crippling costs associated with the design and implementation of governance measures will swiftly snuff out the entrepreneurial spirit among the officers and boards of many small companies. While not advocating a return to a regulatory "Wild West," adherents to this argument do want to encourage and nurture a healthy entrepreneurial environment. Such proponents view the imposition of burdensome governance standards on all companies as an impediment to SMEs seeking listings as a capital markets option.

Alternative Investment Market companies. The UK is a jurisdiction with a two-tier system of governance principles and standards with the Alternative Investment Market (AIM) frequently described as "lightly" regulated by the London Stock Exchange as compared with the more "tightly" regulated main market.[2] Recent governance surveys by PricewaterhouseCoopers and others have concluded that the record of AIM companies on governance issues is "patchy."[3] In our view, this is unacceptable. Like Cadbury, Hampel and Higgs, our starting point is that "high standards of corporate governance are as important for smaller listed companies as for listed ones. All public companies, irrespective of size, have obligations to their owners."[4]

QCA Code. In 2010, the Quoted Companies Alliance promulgated a set of Corporate Governance Guidelines for Smaller Quoted Companies (QCA Code).[5] The key underpinnings of the QCA Code include transparency and trust between boards and shareholders, constructive and active engagement between shareholders and company boards, and high quality communications by boards. The QCA Code also acknowledges that each company has its own set of circumstances – robust corporate governance processes need to be tailored accordingly.

The 12 essential guidelines of the QCA Code are worth paraphrasing at some length:

1. Structure and process. The company should design the most appropriate governance plan, given its corporate culture, size and business complexity. Clarity on plans to fulfil its objectives should be a hallmark of the governance framework.

2. Responsibility and accountability. Where does responsibility lie for the management of the company and the achievement of key tasks? The board has a collective responsibility for the long-term success of the company. The roles of the Chair and CEO should not be filled by the same individual.

3. Board balance and size. Board size must be driven by efficiency of operation. A minimum of two independent non-executive directors. The board should not be dominated by one person or group of people.

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[2] See, e.g., Mellor, John, *Practical Corporate Governance For Smaller Quoted Companies and Private Companies* (Bristol: Jordans, 2008), at page 29.
[3] *Ibid*. at page 38.
[4] Higgs, Derek, "Review of the role and effectiveness of non-executive directors" (UK Department of Trade and Treasury, January 2003) at page 71.
[5] The Quoted Companies Alliance, "Corporate Governance Guidelines for Smaller Quoted Companies" (September 2010), available at QCA: <http://www.theqca.com/shop/guides/26706/corporate-governance-guidelines-for-smaller-quoted-companies-september-2010.thtml>.

4. Board skills and capabilities. A balance of functional and sector skills. Board committee members (audit, remuneration and nomination) should have the "necessary character, skills and knowledge."

5. Performance and development. Periodic performance evaluation of board, board committees and individual directors. Induction and succession should be tied to these evaluations. Update the skill-set analysis of board members. Periodic renewal of board members.

6. Information and support. Accurate, sufficient, timely and clear information for the board and board committees. Access to external advice when necessary.

7. Cost-effective and value-added. Costs related to governance are offset by value-added benefits for the company. How has this value been added? Key performance indicators (KPIs) aligned with strategy. Feedback through regular meetings between shareholders and directors.

8. Vision and strategy. Shared vision. Timetable. Steps to achieve vision. The vision and direction must be well communicated, both internally and externally.

9. Risk management and internal control. Board is responsible for maintaining a sound system of risk management and internal control. Define and communicate the company's risk appetite and how it manages its key risks. Balance between risk management and entrepreneurship. Remuneration policy tied to company objectives whilst encouraging behaviour that is consistent with risk profile of the company.

10. Shareholders' needs and objectives. Dialogue between shareholders and the board. Vested interests vs. the common good of all shareholders.

11. Investor relations and communications. A communication and reporting framework between the board and shareholders.

12. Stakeholder and social responsibilities. Good corporate governance is tied to corporate social responsibility (CSR). Management of social and environmental opportunities and risks. A proactive CSR program, as an integral part of company strategy, can help achieve long-term value and reduce risks.

Our recommendation:

We do not accept the suggestion for the EU corporate governance code to have a differentiated or multi-tier structure with selected governance provisions only applying to companies above a specified size threshold. We do not believe that corporate governance provisions can be prioritized, with some governance provisions falling into the universal bucket of corporate governance measures applicable to all listed companies and other provisions being relaxed or eliminated for SMEs. We do not agree that the difficulties or challenges in applying corporate provisions across the range of structures, sectors, characteristics and sizes of companies are insurmountable. And, we do suggest that a line-drawing exercise between SMEs and larger enterprises for corporate governance reasons is so perilous and fraught with complexities and second-guessing that it should be avoided at all cost.

Bottom line, the need for a uniform architecture of governance provisions is paramount. Investors and other stakeholders must be able to expect basic governance provisions in all listed companies including SMEs.

Our single concession to smaller listed enterprises is to provide limited flexibility through a "comply or explain" governance model. In our view, companies – including SMEs – should be able to explain and justify non-compliance with any aspect of the governance code that is uncomfortably burdensome or non-compatible with the company's prevailing circumstances.

(2)	Should any corporate governance measures be taken at EU level for unlisted companies? Should the EU focus on promoting development and application of voluntary codes for non-listed companies?

Whether one uses the terminology "close corporation," or "private corporation" or "unlisted corporation" or "non-listed corporation," governance of the closely held enterprise will differ significantly from governance of other corporate entities. In all cases, the unlisted company will exhibit one or more of the following characteristics: (i) share ownership is evidenced only by certificated securities held by no more than a specified number of holders or record; (ii) all of the company stock is subject to some restriction on transfer; and (iii) no public offering of company shares is permitted.

How are governance standards and principles different for a non-listed company as compared with standards and principles for listed companies? We offer some examples.

First, under the Delaware corporate statute, stockholders of a close corporation holding a majority of the stock of the company can, in certain circumstances, agree in writing to restrict the discretion or power of the board of directors to manage the business and affairs of the enterprise – and such an agreement is not invalid simply because it restricts directorial discretion. In these circumstances, the directors are relieved of liability "for managerial acts or omissions ... to the extent and so long as the discretion or powers of the board in its management of corporate affairs is controlled by such agreement."

Similarly, the Delaware corporate statute permits the charter document of a close corporation to provide that the "business of the corporation shall be managed by the stockholders ... rather than by a board of directors." This language effectively supplants the role of the board in corporate management. In this case, the stockholders are deemed to be directors and assume the directorial liabilities accordingly.

Thus, Delaware corporate statute law allows owners of a close corporation to vary the ordinary role of directors in corporate governance.

What corporate governance measures should be introduced for unlisted companies? What should be the governance priorities for unlisted companies that want to improve operational and financial performance through better governance?

The diversity of unlisted companies ensures that there will be no "one size fits all" governance solution or approach for unlisted companies.

ecoDa Governance Principles. A set of governance guidelines has recently been promulgated by the European Confederation of Directors' Associations (ecoDa).[6] Under the title *Corporate Governance Guidance and Principles for Unlisted Companies in Europe*, ecoDa stresses that good corporate guidance for unlisted companies is not primarily focused on the relationship between boards and external shareholders as is the case with listed companies. Nor is it focused on box-ticking and regulatory compliance with rules and regulations. Rather, good governance for unlisted companies is centred on building a framework of company processes and attitudes that add value to the business, as well as building reputation and profile and ensuring long-term sustainability and success.

Before reviewing the 14 ecoDa principles of good guidance, it is worth noting that shareholders of unlisted companies have a limited ability to sell their ownership stakes. An absence of liquidity dictates that shareholders are committed in most instances to remaining an investor in the company for the medium- to long-term. Investors' dependence on good governance in unlisted companies is, thus, heightened.

The 14 ecoDa corporate governance principles for unlisted companies are as follows:

1. Shareholders should establish robust constitutional and governance frameworks for the company in its charter documents.

2. Every company should strive to populate its board with effective directors. The directors are collectively responsible for the long-term success of the company, including the crafting and implementation of the company's strategic plan. A placeholder on the path to an effective (and independent) board might be the launch of an advisory board.

3. The size and composition of the board should reflect the scale and complexity of the company's operations.

4. The board should meet with sufficient frequency to discharge fully its duties. Board members must be supplied in a timely manner with appropriate information, reports and data.

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[6] European Confederation of Directors' Associations (ecoDa), "Corporate Governance Guidance and Principles for Unlisted Companies in Europe" (March 2010), available at ecoDa: <www.ecoda.org/docs/ECODA_WEB.pdf>.

5. Levels of remuneration should be sufficient to attract, retain and motivate management and directors of the quality required to achieve the targeted results and performance for the company.

6. The board is responsible for risk management and should maintain an effective framework of internal controls to safeguard shareholders' investment, the company's assets and the company's reputation and future prospects.

7. There should be an ongoing board/shareholders dialogue based on a mutual understanding of company objectives. The board assumes the responsibility for ensuring that a satisfactory dialogue with shareholders takes place. The board should be mindful that all shareholders be treated equally.

8. All directors should undergo detailed orientation or induction on joining the board. Directors must regularly update and refresh their governance skills and company/industry knowledge.

9. Family-controlled companies should establish governance mechanisms that promote co-ordination and mutual understanding among family members. The relationship between family governance and corporate governance must be coordinated.

10. There should be a demarcation between the running of the board and the running of the business. That is, the Chair and the CEO should be two separate individuals. No one individual should have unfettered powers of decision.

11. The aggregation of director skill-sets on a board will vary depending on regulatory requirements and business norms. All boards should include members with a sufficient mix of appropriate competencies and experiences. No single person (or small group of individuals) should dominate the board's discussion or decision-making.

12. The board should establish appropriate board committees to allow for a more effective discharge of its duties.

13. Periodically, the board should undertake a rigorous appraisal/evaluation of its own performance and that of each individual director.

14. The board should present a balanced and coherent assessment of the company's position and prospects for external stakeholders. The board should design a suitable program of stakeholder engagement and activism.

Our recommendation:

Our view is that the governance issues faced by unlisted companies have been relatively neglected to date by governance commentators and experts. This neglect should be remedied immediately by adopting the 14 governance principles promulgated by ecoDa. Above all, though, the essence of the closely held enterprise – its vision, its mission, and its values – is what matters.

The detailed governance framework for unlisted companies, in our view, should be firm and transparent without being stifling or burdensome. Indeed, the ecoDa governance principles and the related guidance stress that a firm's governance framework should be implemented in a way that is both proportionate and realistic. And it should evolve over the company's business and operational lifecycle.[7]

Boards of Directors

(3)	Should the EU seek to ensure that the functions and duties of the chairperson of the board of directors and the chief executive officer are clearly divided?

The EU should take reasonable steps to ensure that the functions and duties of the chairperson of the board of directors and the CEO are clearly divided. The rationale for this division of duties is the conflict of interest if a CEO is accountable to a board led by him- or herself.

The division of the functions and duties of a "non-executive" chairperson (Green Paper, p. 5) from those of a CEO, however, is inadequate to ensure the *independence* of this chairperson.[8] The chairperson should be independent from management of the company; of any "dominant or controlling shareholder" of the company (Green Paper, p. 11); and of any other relationship or association that could be reasonably perceived to compromise this independence. The basis of this independence of the chairperson should be affirmatively determined, published, and readily accessible by investors and other key stakeholders.

The identities, functions and duties of the chairperson of the board of directors, of the chairperson of each principal committee of the board, and of the CEO and the most senior financial officer (CFO) should be published and accessible in the form of clear position descriptions. These position descriptions should delineate roles, responsibilities, accountabilities and competencies required for each role, together with competencies and other attributes possessed by the incumbents to the positions. The EU should consider providing guidance or descriptors to ensure that these position descriptions are sufficiently detailed and complete and not boilerplate in nature.

These position descriptions should form the basis of the appointment, performance assessment and succession planning. Position descriptions for the board and committee chairs and the CEO are quite common in Canada, since publication of National Policy 58-201,[9] and good examples can be found at the Canadian Imperial Bank of Commerce and Cameco Corporation (bank and natural resource company, respectively).[10]

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[7] See, e.g., Bain, Neville, and Barker, Roger, *The Effective Board* (London: Kogan, 2010), at page 155.
[8] See Leblanc, Richard, and Pick, Katharina, "Separation of Chair and CEO Roles: Importance of Industry Knowledge, Leadership Skills & Attention to Board Process," in press, Conference Board (New York, August 2011 expected).
[9] See section 3.5 of "National Policy 58-201: Corporate Governance Guidelines," available online: Ontario Securities Commission <http://www.osc.gov.on.ca/en/SecuritiesLaw_rule_20050617_58-201_corp-gov-guidelines.jsp>.
[10] See, e.g., Mandate of the President and CEO, Chair of the Board and Committee Chair, available online at the Canadian Imperial Bank of Commerce: <https://www.cibc.com/ca/inside-cibc/governance/board-of-directors/mandates.html>; and Chair's Role and CEO's Role, available online at Cameco Corp.:

(4) Should recruitment policies be more specific about the profile of directors, including the chairman, to ensure that they have the right skills and that the board is suitably diverse? If so, how could that be best achieved and at what level of governance, i.e. at national, EU or international level?

Recruitment policies should be more specific about the profile of directors, including the chairman, to ensure that boards have the right skills and are suitably diverse. This objective can be achieved by the following recommendations:

The skills, knowledge, experience and attributes possessed by individual directors should be published and accessible in the form of a "competency" or "skills" matrix, wherein competencies of the board as a whole should possess are listed, defined, revised as necessary, and the number of directors possessing varying degrees of various competencies are affirmatively determined and validated.

A definition for competency: "synthesized from the suggestions of several hundred HR experts at a Johannesburg conference, is 'a cluster of related knowledge, skills and attitudes that affect a major part of one's job (a role or responsibility), that correlates with performance on the job, that can be measured against well-accepted standards, and that can be improved via training and development.'"[11]

Two examples of a director competency matrix follow, from Nexen Inc. and BHP Billiton, for illustrative purposes:[12]

<http://www.cameco.com/responsibility/governance/chairs_role/> and <http://www.cameco.com/responsibility/governance/ceos_role/>, respectively.

[11] Parry, Scott B., "Just What Is a Competency? (And Why Should You Care?)," Training, June 1998, pages 58-64, quoted within Leblanc, Richard, letter to the SEC, "Request for Comment – File No. S7-13-09, Proxy Disclosure Enhancements," July 13, 2009.

[12] Available online at Nexen Inc.: <http://www.nexeninc.com/en/Governance/BoardofDirectors/AreasofExpertise.aspx>; and at page 133 of "Section 5 Corporate Governance Statement 2010," available online at BHP Billiton: http://www.bhpbilliton.com/home/aboutus/ourcompany/Pages/governance.aspx, respectively.

This example is from Nexen Inc:

Directors use the skills matrix to review and self-assess their skills each year. The results are used to enhance the development of the board, assist in the recruiting process and identify potential areas for training or education. Directors indicate their expertise level in each area according to:

1. no or limited application;
2. basic application—some limited experience or knowledge in the area, but not at a senior executive level and/or not in the oil and gas industry;
3. skilled application—significant operational or functional experience or knowledge in the area, but not at a senior executive level; and
4. expert application—senior executive experience in function, role or knowledge area.

The areas of expertise set out in the nominee directors' biographies are those areas in which they are most skilled. Directors' qualifications and experience as they relate to the areas of expertise can be found in Experience and Qualifications.

Specific Skills / Experience Description

Strategic Insight / Leading Growth

Experience driving strategic insight and direction to encourage innovation and conceptualize key trends to continuously challenge the organization to sharpen its vision while achieving significant growth.

Number of Nominee Directors with Skilled or Expert Application: 12

International

Experience working in an organization with global operations and a thorough understanding of different cultural, political and regulatory requirements.

Number of Nominee Directors with Skilled or Expert Application: 10

CEO / Senior Officer

Experience working as a ceo or senior officer of a large public company or major organization.

Number of Nominee Directors with Skilled or Expert Application: 12

Exploration

Experience in a major upstream or integrated exploration and production company and a strong knowledge of reservoir assessment and exploration and production techniques. may have formal education in geology, geophysics or engineering.

Number of Nominee Directors with Skilled or Expert Application: 6

Human Resource Management

Experience in and a thorough understanding of succession planning, talent development and retention and compensation programs, including executive compensation.

Number of Nominee Directors with Skilled or Expert Application: 11

Oil and Gas

Experience in the oil and gas industry and a strong knowledge of markets, competitors, financial performance, conventional and unconventional business issues, regulatory requirements, technology and reserves.

Number of Nominee Directors with Skilled or Expert Application: 8

Board

Experience as a board or committee member of a major organization with a current governance mindset.

Number of Nominee Directors with Skilled or Expert Application: 12

Financial Acumen

Experience in financial accounting and reporting, and corporate finance, especially with respect to debt and equity markets. understanding of internal financial controls, and ability to assess the application of international Financial reporting standards and/or canadian or u.s. generally accepted accounting principles.

Number of Nominee Directors with Skilled or Expert Application: 9

Sustainable Business Practices

Experience in and a thorough understanding of industry regulations, public policy and the fostering of a corporate culture related to health, safety, environment and social responsibility and other constituents of sound sustainable development practices and reporting and their application to corporate success.

Number of Nominee Directors with Skilled or Expert Application: 11

Public Policy/corporate Relations

Experience in or a strong understanding of the workings of government and public policy, including but not limited to the legal and regulatory environments where Nexen is or may be active. may include experience in or a thorough understanding of communication and media perspectives.

Number of Nominee Directors with Skilled or Expert Application: 11

Marketing

Experience in or a strong understanding of the energy marketing industry and a strong knowledge of Nexen's strategy, markets, competitors, financials, operational issues and regulatory concerns.

Number of Nominee Directors with Skilled or Expert Application: 4

This example is from BHP Billiton Limited:

5.3.3 Skills, knowledge, experience and attributes of Directors continued

Skills and experience	Board	Risk and Audit	Nomination	Remuneration	Sustainability
Managing and leading Sustainable success in business at a very senior level in a successful career.	10 Directors	2 Directors	3 Directors	4 Directors	3 Directors
Global experience Senior management or equivalent experience in multiple global locations, exposed to a range of political, cultural, regulatory and business environments.	11 Directors	3 Directors	3 Directors	4 Directors	3 Directors
Governance Commitment to the highest standards of governance, including experience with a major organisation, which is subject to rigorous governance standards and an ability to assess the effectiveness of senior management.	11 Directors	3 Directors	3 Directors	3 Directors	3 Directors
Strategy Track record of developing and implementing a successful strategy, including appropriately probing and challenging management on the delivery of agreed strategic planning objectives.	11 Directors	3 Directors	3 Directors	4 Directors	3 Directors
Financial acumen Senior executive or equivalent experience in financial accounting and reporting, corporate finance and internal financial controls, including an ability to probe the adequacies of financial and risk controls.	11 Directors	3 Directors	3 Directors	4 Directors	3 Directors
Capital projects Experience working in an industry with projects involving large-scale capital outlays and long-term investment horizons.	9 Directors	2 Directors	3 Directors	3 Directors	3 Directors
Health, safety and environment Experience related to workplace health, safety, environment and social responsibility with a major corporation.	10 Directors	3 Directors	3 Directors	3 Directors	3 Directors
Remuneration Board remuneration committee membership or management experience in relation to remuneration, including incentive programs and pensions/superannuation and the legislation and contractual framework governing remuneration.	11 Directors	3 Directors	3 Directors	4 Directors	3 Directors
Mining Senior executive experience in a large mining organisation combined with an understanding of the Group's corporate objective to create long-term value for shareholders through the discovery, development and conversion of natural resources.	5 Directors	1 Director	0 Directors	1 Director	2 Directors
Oil and gas Senior executive experience in the oil and gas industry, including in-depth knowledge of the Group's strategy, markets, competitors, operational issues, technology and regulatory concerns.	5 Directors	1 Director	2 Directors	3 Directors	1 Director
Marketing Senior executive experience in marketing and a detailed understanding of the Group's corporate objective to create long-term value for shareholders through the provision of innovative customer and market-focused solutions.	9 Directors	1 Director	3 Directors	4 Directors	3 Directors
Public policy Experience in public and regulatory policy, including how it affects corporations.	10 Directors	2 Directors	3 Directors	4 Directors	3 Directors
Total directors	11 Directors	3 Directors	3 Directors	4 Directors	3 Directors

Director qualifications

- Business/Finance, 5 Directors
- Engineering and Science, 2 Directors
- Science, 2 Directors
- Engineering, 2 Directors

Non-executive Director locations

- US, 3 Directors
- Australia, 4 Directors
- UK, 1 Director
- South Africa, 1 Director
- Hong Kong, 1 Director

The results of the competency matrix assessment (see above two examples from Nexen Inc. and BHP Billiton) is intended to result in a gap analysis and a profile for the nomination of prospective directors; inform the committee rotation and retirement of incumbent directors; and be utilized in identifying prospective directors for membership on the board.

Director Profile

In becoming more specific about the profile of directors, as per the Green Paper question # 4 above, best practice is that director background should be published and accessible (including on the company website), including independence and the basis of determination, age, tenure, domicile, meeting attendance, compensation (all forms, including cash, shareholdings and stock-related instruments, on a director-by-director basis), committee chairship and membership (as applicable), educational activities, other directorships, and individual areas of expertise, for each director. <u>This disclosure should be clear, complete, current, accurate, understandable, and use updated website technology and design</u>.

Desired attributes possessed by directors should also be published. These attributes may include accountability; independent-mindedness; business judgment; communication skills; teamwork; commitment; and analytical abilities.[13] A position description for individual directors should also be developed, published and regularly revised.

The National Policy 58-201 is explicit concerning the importance of qualities of directors and determination of the board dynamic: "Attention should also be paid to the personality and other qualities of each director, as these may ultimately determine the boardroom dynamic."[14]

Board Chair Profile

For the board chairperson, two important competencies would include leadership skills and industry knowledge.[15] Others would include independence, integrity, holding others to account, and coaching and development.

Ensuring Board Diversity

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[13] These attributes may be affirmed and published, e.g., "All of our board members have these…," which limits the utility of such a statement. Directors may possess these attributes to varying degrees, and such possession contributes to individual effectiveness and overall board dynamics. These attributes and director behaviours should therefore comprise part of a competency matrix, and be assessed for prospective and incumbent directors.

[14] See "National Policy 58-201 Corporate Governance Guidelines," available online, supra note 9, <http://www.osc.gov.on.ca/en/SecuritiesLaw_rule_20050617_58-201_corp-gov-guidelines.jsp>, at 3.12 (B). See also Chapter 8: Director Behavioral Types, within *Inside the Boardroom*, by Leblanc, Richard, and Gillies, James (Toronto: Wiley, 2005).

[15] See, e.g., Recommendation 8 within "A review of corporate governance in UK banks and other financial industry entities," Walker et al., 26 November 2009, at page 60. See also Section A: Leadership, within the UK Corporate Governance Code, June 2010, at pp. 9-11.

The foregoing recommendations, in respect of director (and chair) profile and competencies, may be implemented at the national, EU or international levels of governance. These recommendations may *not*, however, necessarily ensure that a board is suitably diverse, depending on how "competency" and "diversity" are defined, treated and made transparent by the board to stakeholders. We address diversity explicitly in question 5 that follows, and gender diversity in particular, in question 6. However, diversity is introduced and addressed in this question, given the definition and positioning of diversity within a director competency matrix and an overall director profile.

The strong desire for executive experience – and in particular, CEO and C-suite operating experience – as part of a board makeup, could have the undesired effect of systemically discriminating against women and minorities.

Therefore, some boards have chosen to accord primacy to diversity considerations explicitly, in the form of designated groupings for individuals (e.g., women, visible/racial minorities, Aboriginal Peoples and persons with disabilities, as a Canadian example) within a competency matrix.

Second, some boards have exercised care in defining competencies (such as different forms of leadership, market knowledge, board experience and functional capabilities) with a view to being inclusive and not unintentionally disadvantaging prospective directors, but still draw on the best-qualified directors to lead the company.[16]

Some forms of diversity – for example professional diversity and gender diversity, as identified in the Green Paper – may transcend nation state boundaries (e.g., financial acumen and women, as examples from the Green Paper). There are, however, nuances – such as industries that have been, and still are, male-dominant (mining or heavy industry, for instance); whereas other industries have made somewhat greater progress towards achieving (but certainly far from reaching) desired gender parity (e.g., financial services or consumer products industries) at board and senior management levels. Companies may operate in certain languages, milieus and jurisdictions, and doing so may affect the need for international diversity (the third type of diversity identified in the Green Paper). Therefore the talent pools (or the supply of directors) and the needs (or the demand for directors) may not be equal or generalizable across industries and jurisdictions. Therefore diversity considerations (in all of its forms[17]) should address this reality.

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[16] For example, "Enterprise Leadership" as a competency could have sub-competencies of CEO/GM of large organization; CEO/GM of small organization; Other Experience with Small/Medium Organization; Active Professional; Volunteer/Community Organization; Leading/Managing Growth; and Experience "Under Fire."

[17] We use the example above of women, visible/racial minorities, Aboriginal Peoples and persons with disabilities, as examples of designated diversity groupings. The Green Paper speaks to (in this order) professional diversity, international diversity and gender diversity. Diversity groupings may also include, in no particular order, age (explicitly identified in Australia), socio-economic diversity, sexual orientation and military service.

(5)	Should listed companies be required to disclose whether they have a diversity policy and, if so, describe its objectives and main content and regularly report on progress?

Board diversity has been at the forefront of societal debates as it is recognized that there are systemic barriers preventing equal opportunity and a belief that diverse boards may produce more effective decision-making and mitigate groupthink within boardrooms in the aftermath of the global financial crisis.

Arguments for greater diversity in boardroom representation have been explored following two approaches. The first is based on economic arguments and considers that firms who fail to select the most able candidates damage their financial performance.[18] The latter rests upon a moral viewpoint, arguing that it is wrong for women to be excluded from corporate boards on the grounds of gender. While research cannot clearly prove or disclaim the financial benefits of greater diversity for all firms,[19] the moral case has gained attention and is seen as sufficient to drive change. Such being the case, we recommend companies be legally required to ensure a better gender balance on boards.

There are different approaches to increase the representation of women on boards: coercive measures via government intervention as initiated by Norway in 2002, or a more liberal approach that relies on voluntary corporate commitment, such as is seen in North America. An interesting alternative "report or explain" model was recently put in place by the Australian Securities Exchange's Corporate Governance Council urging companies to disclose:

i. The measurable gender diversity objectives set;
ii. The progress towards achieving them; and
iii. The proportion of women within the board and senior management.

Companies are not required to commit to these diversity measures, but they are required to explain their decision in their annual report. While it is too early to assess the full impact of the Australian model, since the changes were announced, women have gone from 5% of new board appointments to 27%.[20]

The main objective of a diversity policy is, first and foremost, to compel directors and senior officers (at the very least) to reflect on their position with regards to diversity of board and senior

[18] For example, excessive compensation has also been tied to the absence of cultural diversity in the boardroom. See Malsch, B., Tremblay, M. S. and Gendron, Y. (2011), "Sense-making in compensation committees: a cultural theory perspective," in. Université Laval.
[19] For example, other benefits to gender-diverse boards that some studies have identified include higher attendance, enhanced monitoring roles, and a greater propensity to replace poorly performing CEOs. See Leblanc, R., "A Fact-Based Approach to Boardroom Diversity," Director Journal (March 2011) Institute of Corporate Directors, Issue 154 at p. 8. Second, diversity policies for board members have been suggested as one way of tackling problems and rejecting the groupthink that may have contributed to the challenges we face. See Ernst and Young (2009), "Groundbreakers. Using the strength of women to rebuild the world economy."
[20] Available online, BIS: <http://www.bis.gov.uk/assets/biscore/business-law/docs/w/11-745-women-on-boards.pdf>.

management membership, and then to inform stakeholders on their chosen objectives and their progression.

In our opinion, the European Commission should go beyond the US model adopted in late 2009[21] by the Securities and Exchange Commission, whereby companies are required to disclose: (i) whether, and if so how, a nominating committee considers diversity in identifying nominees for director; (ii) whether a company has a policy with regard to the consideration of diversity, in identifying director nominees; and (iii) how this policy is implemented and its effectiveness is assessed. While it is too early to evaluate the impact of this US directive, in our view, there is too much ambiguity in the interpretation and possible application of this directive.[22]

The advantage of the Australian model lies in its clarity and measurability. Australia defines diversity to mean include "gender, age, ethnicity and cultural background."[23] However, failure to comply in both the US and Australia does not appear to result in regulatory penalties or delisting.[24] It seems reliance on resulting bad press and investor and other stakeholder scrutiny following failure to report was deemed sufficient. On this point, we feel the European Commission should incorporate penalties/sanctions to give diversity disclosure regulation traction and in the hopes of avoiding the ultimate solution of gender quotas, which have the advantage of quickly transforming gender in boardrooms, as has been the case in Norway; however, this most extreme option is often greeted with much opposition.

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[21] Available online, SEC: <http://www.sec.gov/rules/final/2009/33-9089.pdf>.

[22] See, e.g., Luis A. Aguilar, "Speech by SEC Commissioner: Diversity in the Boardroom is Important and, Unfortunately, Still Rare" (Speech at the SAIS Center for Transatlantic Relations Closing the Gender Gap: Global Perspectives on Women in the Boardroom, Washington, D.C., 16 September 2010). Available online, SEC: <http://www.sec.gov/news/speech/2010/spch091610laa.htm>:

> "Unfortunately, while some companies provided useful information in the spirit of the SEC rule, **many other companies provided only abstract disclosure** — often times limiting their disclosure to a brief statement indicating diversity was something considered as part of an informal policy. Many companies did **not include any discussion of any concrete steps taken to give real meaning to its efforts to create a diverse board.** By leaving out the steps taken and how those efforts are evaluated, these companies fail to provide investors with useful information, and it deprives investors of information they have demanded. I have asked our staff to follow up with some of these companies and I expect this disclosure to improve." [emphasis added].

[23] "Corporate Governance Principles and Recommendations with 2010 Amendments," 2nd ed. (ASX Corporate Governance Council), Recommendation 3.2, Commentary: "Diversity includes, but is not limited to, gender, age, ethnicity and cultural background." at p. 24 of 49, available online: ASX: <http://www.asxgroup.com.au/media/PDFs/cg_principles_recommendations_with_2010_amendments.pdf> See also, "Diversity – resources for listed entities," available online: ASX: <http://www.asxgroup.com.au/diversity-resources.htm>.

[24] In the US, failure to disclose at all may result in a comment letter for which the company has 10 days to reply. See, e.g., letter from the SEC to Republic Airways Holdings Inc., dated 24 September 2010, at page 1: "Please confirm that in future filings you will disclose whether, and if so how, you consider diversity in identifying nominees for director. Refer to Item 407(c)(2)(vi) of Regulation S-K. …" It is not known if a failure to respond, in respect of this diversity disclosure requirement, could ultimately result in de-listing.

(6) Should listed companies be required to ensure a better gender balance on boards? If so, how?

Legislators, advocates and academics have long followed board composition, including the slow advancement of women onto corporate boards despite four decades of equal opportunity policies.[25] At the current rate, it is estimated that it will take more than 70 years to achieve gender balance boardrooms in Canada, for example.

Regulatory approaches to board diversity range from rules requiring disclosure of diversity plans by boards, with "diversity" itself sometimes undefined by the regulator (as in the United States, established in 2010), to hard gender quotas. Such quotas range from 20% to 40% (in jurisdictions such, Norway, France, Spain, Belgium and Iceland).

The recent Canadian experience, which includes the defeat of Senate Bill-206 mandating a 50% quota on boards, illustrates the highly controversial nature of quotas. However the voluntary corporate commitment measures adopted in the US are not likely to yield significant results. Therefore, we recommend a middle approach based on the Australian regulation, which defines diversity and requires that measureable targets be set in order to assess objectives and evaluate progress. The hope is that what gets measured gets done.

However, women have concerns about the need for appointments to be seen to be made on merit. Therefore a 30% to 40% target strikes a sensible balance to achieve better representation without tokenism.[26] We also recommend that these targets include a timeline and that they be accompanied by greater transparency in recruitment processes that could range from public posting of board positions to detailed description of the mix of skills each board member brings to the table (see question 4 above).

(7) Do you believe there should be a measure at EU level limiting the number of mandates a non-executive director may hold? If so, how should it be formulated?

Duty of care. To state the blindingly obvious, a cornerstone principle undergirding all governance codes is that directors must dedicate sufficient time to fulfil their duties as board members. This basic duty is referred to as the "duty of care" (or the "duty of attention.")

As the name implies, the "duty of care" involves the concern, attention, skill, devotion, involvement, commitment and diligence that directors are expected to exercise in discharging their duties. The duty of care is a common law doctrine – that is, one created by judges and judicial decisions or opinions – although many jurisdictions have codified the essential elements of the duty.

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[25] Terjesen, S., Sealy, R. and Singh, V. (2009), "Women Directors on Corporate Boards: A Review and Research Agenda," Corporate Governance: An International Review, Vol. 17 No. 3, at pages 320-337.
[26] McKinsey&Company (2008). "Room at the top: Women and success in UK business." Report written by Meaney. M., Devillard-Hoellinger,S., & Denari, A.

Various commentators have pointed out that "care" has a somewhat specialized meaning in this governance context. It must not be confused with "caution." After all, taking measured or reasonable risks is an essential part of doing business.

But "care" clearly ***does*** entail on the part of directors a commitment, dedication, and ability to contribute necessary time, preparation, study and reflection.[27]

Two astute and experienced commentators on governance matters, Martin Lipton of Wachtell, Lipton, Rosen & Katz of New York and Jay Lorsch of the Harvard Business School, have concluded that: "Based on our experience, the most widely shared problems directors have is a lack of time to carry our their duties."[28] That is, directors' responsibility to oversee management is undermined by the fact that many directors are unable to devote sufficient time or resources to the task. This observation obviously has considerable bearing on whether directors should be limited or restrained in accepting additional governance mandates.[29]

Lipton and Lorsch continue by stating that, for a director to do his or her job properly, he/she needs to devote at least 100 hours annually to the role. More recent analyses suggest that directors must be able to devote at least 250 hours a year to each board position **where the company has no specific problems**. When there is a crisis, that marker can quickly escalate to full time. Because so many directors serve on more than one board, in addition to having a full-time career, they are quite unable to contribute or dedicate the appropriate amount of directorial time.

Interestingly, the countervailing argument in favour of individuals filling a large number of governance roles concurrently has numerous adherents. Anecdotally, one can point to many leaders, giants and stalwarts in the governance field who have served successfully on many corporate and non-profit boards simultaneously.[30] Directors, it is argued, improve their judgment and decision-making abilities by expanding their portfolio of experiences. We agree with this perspective – but only up to a point. Diminishing returns set in at some point for all individuals. Indisputably, all directors, as pointed out by Lipton and Lorsch, eventually become ineffective in fulfilling their governance responsibilities because of time deficits.

Solutions to overboarding. What is the solution to what we refer to as "overboarding" or excessive board positions held by individual directors?

Our experience suggests that simple solutions do not work in complex environments. Therefore, a simple formulaic cap on numbers of board positions, for the following reasons, is not a feasible answer:

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[27] National Association of Corporate Directors, "Director Liability: Myths, Realities and Prevention" (NACD: Washington, 2005) at pages 32-34.
[28] Lipton, Martin, and Lorsch, Jay W. (1992) "A Modest Proposal for Improved Corporate Governance" *Business Lawyer* 48, 1 at page 64.
[29] Monks, Robert A.G., and Minow, Nell, *Corporate Governance*, 4th ed. (Hoboken, NJ: Wiley, 2008) at page 261.
[30] Dimma, William A., *Tougher Boards for Tougher Times* (Toronto: Wiley, 2006) at page 183.

First, different corporate boards require differing levels of involvement and time commitment by individual directors. Imposing a maximum number of board positions on individual directors assumes a somewhat similar set of expectations of board members by all companies in all sectors. This assumption is clearly flawed. The varying complexity of issues considered at the board level; the significant issues imposed by insolvency situations; the challenges and time pressures associated with material mergers, acquisitions, restructurings and financings; the evolving regulatory environment and its impact on companies; the ongoing operating dynamic between boards and management teams; the reliance on board committees to analyze, investigate and resolve important issues; and the operating challenges encountered by various companies —all these realities generate differing levels of monitoring and decision-making by boards. These factors, among others, have a significant bearing on the amount of director time required to fulfil directorial and other governance responsibilities.

Second, there are many weighty distractions experienced by directors that influence whether a director is able to dedicate sufficient time to fulfil his/her governance duties. Other board positions, health issues and complications, travel obligations, family commitments, extracurricular interests, and career and related work responsibilities are just a few. Because these distractions are experienced in varying degrees by individual directors, it is inappropriate – perhaps impossible – to generalize about directors' abilities to absorb or take on additional responsibilities and tasks.

Third, individual directors have varying capacities to cope with the responsibilities associated with multiple director positions. Cries of "unfair" and "inequitable" would greet any attempt to standardize limits or thresholds on numbers of director positions assumed concurrently by individual directors. Those directors who have a compelling understanding of important governance issues or who are prepared to dedicate extraordinary time to deal with, and understand, and analyze, and reflect upon important governance issues should have the ability to assume multiple board positions as long as these directors adequately fulfil all of their governance responsibilities. Penalizing individuals who demonstrate an unwavering dedication and commitment to become "professional directors" would be wrong.

Finally, any regulatory or legislative initiative to limit board positions by individual directors would likely have a negative impact on the availability of sufficient suitable directors to fill vacant board positions and future vacancies. Experienced directors might be denied the opportunity to take on additional directorships. Thus, the pool of qualified directors available to fill a position might be diminished. Also, a limit on concurrent board positions would likely have a more pronounced impact on the ability of small private enterprises to recruit effective and experienced directors. If an individual corporate director is limited to a maximum number of directorial positions, he or she will likely opt for the better-paying and higher profile large enterprises.

What, then, are the effective solutions to overboarding?

Moral suasion – or encouraging a reasonableness standard on maximum board positions for individual directors – has been tried by some companies. Without setting a numerical cap on board memberships, some public boards stipulate that all board members should have "significant time available to devote to board activities, to enhance their knowledge of the relevant industry and related industries, and to attend annually some meaningful per cent (say, 90 per cent) of the scheduled board and board committee meetings." Each board member is encouraged to limit the number of other public company boards on which he or she serves so that such other directorships and commitments do not interfere materially with his or her services as an effective member of the company's board.

The Higgs Review of 2003 – under the leadership of Derek Higgs and which built upon the governance building blocks created by Sir Adrian Cadbury and Sir Ronnie Hampel and Sir Richard Greenbury – offers a very useful sample retainer letter for non-executive directors. The letter states in part:

> "Overall we anticipate a time commitment of [number] days per month after the induction phase. This will include attendance at [monthly] board meetings, the AGM, [one] annual board away day, and [at least one] site visit per year. In addition, you will be expected to devote appropriate preparation time ahead of each meeting.
>
> By accepting this appointment, you have confirmed that you are able to allocate sufficient time to meet the expectations of your role. The agreement of the chairman should be sought before accepting additional commitments that might impact on the time you are able to devote to your role as a non-executive director of the company."[31]

Other companies have created a numerical threshold, which prevents directors from exceeding a formulaic cap in terms of other professional activities and offices held in associations. Appointments as an executive director or as a non-executive director are assigned weightings, which, in the aggregate, cannot exceed a specified arithmetic threshold. The weightings are further adjusted depending on whether the position is with a listed or unlisted company and whether the work commitment (measured in days per month) is significant or not. Further, the board may, under certain circumstances, grant exceptions to the formulaic rule.

Other companies have imposed numerical limits on the number of "administration and control offices" that can be held concurrently with executive director and non-executive director positions. The limits vary considerably. As a non-executive director, the range of maximum additional offices held concurrently is between three and six whereas for an executive director the range is between zero and three.[32]

Institutional Shareholder Services (ISS), an influential proxy voting organization, is a leading provider of corporate governance solutions to the global financial community. Institutional investors rely on ISS to help them make informed investment decisions on behalf of the owners of companies. ISS has recommended proxy voting guidelines relating to, among other things, overboarding. As a general rule, the ISS cap is set at five board appointments. And there are reduced additional-appointment levels recommended for executive directors and chairmen.

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[31] Higgs, supra note 4, at page 107.
[32] National Association of Corporate Directors, "NACD Blue Ribbon Commission on Director Professionalism" (NACD: Washington, 2005).

Our recommendation:

Instead of limiting the number of board mandates held concurrently by a director, we advocate full disclosure of all executive and non-executive positions held by individual directors. We also recommend transparency in terms of committee work, projects, task forces and other commitments and obligations by individual directors for all organizations. Finally, we recommend the disclosure and publication of individual director evaluations for all individuals, particularly where they identify time commitment and other possible shortcomings by individual directors. On the basis that sunlight is the best disinfectant (Brandeis), we believe that full disclosure of governance responsibilities assumed by individual directors will gradually drive overboarding offenders to relinquish excessive governance positions.

(8) Should listed companies be encouraged to conduct an external evaluation regularly (e.g. every three years)? If so, how could this be done?

There is an inherent conflict of interest in any body assessing its own performance. If or when a board of directors lacks the time or resources to carry out the evaluation, and the evaluation is conducted internally to the company, management may design an evaluation questionnaire and administer the results. This additional conflict of interest (i.e., the reasonable perception of self interest on the part of management in participating in an evaluation that includes oversight of themselves) could affect board evaluation design, anonymity, candour, results and reporting. In addition, if a board chair carries out or oversees the evaluation (or even impedes or unduly influences it), and if there exist concerns with the chair's performance, this factor may also compromise the effectiveness of the evaluation and hence of the board.

There is merit, therefore, in encouraging boards of directors to have an external evaluation (including evaluation of board committees and individual directors) conducted regularly (e.g., every three years), for independence, rigour, objectivity and assurance purposes. This approach has been adopted in the UK.[33] However, there has been inadequate guidance offered within the UK Code on how external evaluations should occur, which is the question the Green Paper asks. We offer the following commentary and recommendations, in some detail, based on experience undertaking independent external evaluations of boards of directors.

Role of the Governance Committee

The governance committee of the board should possess explicit authority within its charter to appoint, compensate, oversee and retain an external board evaluation provider – similar to authorities for audit and remuneration committees to retain auditors, remuneration consultants, legal counsel and other advisors, respectively, subject to shareholder approval as necessary. Management, the board chair, or a significant shareholder should not unduly influence the selection of, the relationship with, the reporting by, or the findings of, the board evaluation

[33] See code provision B.6.2: "Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years." Financial Reporting Council, "The UK Corporate Governance Code," June 2010 at page 17.

provider. The board evaluation provider should consider the governance committee to be the client, and should be accountable to that committee rather than to management. The governance committee, in its discretion and within its charter, should be empowered to conduct an executive or in camera session with the board evaluation provider (or the full board in the judgment of the governance committee), at any stage in the evaluation (inception and interim or final reporting).

External Board Evaluation Provider

The external board evaluation provider retained by the governance committee should be independent, qualified and restricted from providing non-board evaluation related services (e.g., consulting, head-hunting, or any other services that would give rise to a conflict of interest). The board evaluation provider's remit should include facilitating the evaluation of the board (including the board chair); the standing committees of the board (including committee chairs); and the individual directors.

Information should be collected and analyzed by the board evaluation provider for report preparation purposes from a questionnaire(s) of directors at a minimum (and certain members of management if considered appropriate in the view of the governance committee); from interviews between the board evaluation provider and directors (as interviews often yield additional information and context, and certain members of management if considered appropriate in the view of the governance committee); and from observation of the board and/or committee(s) in session (in the view of the governance committee). Each director should affirm that the responses provided to the board evaluation provider (questionnaires, and interviews if applicable) represent an accurate and independent representation of his/her views.

Board Evaluation Report

The external board evaluation provider should submit a written board evaluation report based on the foregoing sources of information (questionnaire, interviews and observation), the analysis and the judgment employed by the board evaluation provider, to the governance committee. The board evaluation report should be made available to other directors (and, in its entirety or a portion thereof, to certain members of management if considered appropriate in the view of the governance committee).

The board evaluation report should report on the effectiveness and contribution of the board, the board chair, each standing committee, and each committee chair, on an unattributable director basis (i.e., director remarks or constructive suggestions for improving effectiveness and contribution are anonymous) and should be consistent with the country's or region's relevant corporate governance code or guidelines.

With regard to the effectiveness and contribution of individual directors, unless directors have agreed otherwise, individual reports should be submitted by the board evaluation provider to each director on a director-by-director (also unattributable) basis, with copies to the board and governance committee chairs for interview and developmental purposes.

Internal Discussion and Reporting

The board chair should conduct an individual in-person session with each director based on the results of each director's evaluation, and take follow-up action as necessary. The chair of the governance committee should conduct an individual in-person session with the board chair based on the results of the board chair's evaluation, and recommend follow up action as necessary. Each committee chair should have an in camera session with each respective committee, and report in writing to the governance committee chair on each committee's evaluation and follow-up action taken, or to be taken, as necessary.

The governance committee chair should report to the board of directors in writing (with all or part of his or her report provided to certain members of management if considered appropriate in the view of the governance committee) on the results of the board, committee and director evaluations (the latter in aggregate), and recommend follow up action as necessary, in the form of a governance committee board evaluation statement. The board chair should report to the board of directors in writing on the results of director interviews in the form of a board chair director evaluation statement. The governance committee chair should report to the board of directors in writing on the results of the board chair evaluation, and the board chair should leave the room for discussion purposes at this time. The results of board, committee and individual director evaluations (board and committee chairs, and other directors) should greatly assist board and committee leadership, appointments, membership, and continued tenure in these roles.

External Board Evaluation Statement

Shareholders and other stakeholders should have assurance that the foregoing reporting and recommended courses of action, follow up and remediation have taken place, as necessary. The governance committee on behalf of the board should report to shareholders and other key stakeholders on the process, outcomes and actions taken in respect of the board, committee and individual director evaluations, via a one- or two-page board evaluation statement, authored by the chair of the governance committee and attested to by the external board evaluation provider.[34] The attestation should affirm that the board evaluation statement is consistent with the process and outcomes of the board evaluation report. The name, independence, qualifications and

[34] Therefore we disagree with the EU that "any evaluation statement to be disclosed should be limited to explaining the review process." (page 8 of Green Paper). See, e.g., Institute of Chartered Secretaries and Administrators, "Board Performance Evaluation: Review of 2008 Annual Reports of UK Listed Companies" (February 2009), wherein substantive outcomes of board evaluations are disclosed for numerous companies. See also the Ontario Securities Commission, "Canadian Securities Regulators Seek Comments on Revised Corporate Governance and Audit Committee Regimes" (proposal, December 19, 2008, after which it was withdrawn shortly after the height of the Global Financial Crisis in September 2008), at Principle 4(a): "Describe any practices the board uses… including (iii) the assessment process and outcomes…" [emphasis added]. See also, as a third example, "Annex 5: Illustrative statement on a BOFI's [Board of a Financial Institution's] evaluation process," within "A review of corporate governance in UK banks and other financial industry entities" (Draft report), Walker et al., 16 July 2009, at page 114, wherein five ((a)-(e)) board evaluation outcome-oriented items are discussed.

remuneration of the external board evaluation provider should be published.[35]

A board evaluation statement should address: the main features of the evaluation; the fulfillment of applicable charters and position descriptions; that there is information and a process to identify competencies of individual directors required for constructive challenge of key risks and decisions; access to information and advice; any undue influence on committee review or board decision-making; the nature of engagement between the board and shareholders; and that directors have had opportunity to address the board evaluation report. Outcomes of the board evaluation should be disclosed, such as action upon and prioritizing of results, and actions taken on shortcomings, deficiencies or material weaknesses identified by the evaluation.

A mechanism should exist for shareholders to seek an advisory resolution in respect of the board evaluation statement (e.g., in the event it is unattested, or there is shareholder dissatisfaction with it). The governance committee, on behalf of the board, should respond to any such resolution that results in a not-insignificant withhold or against votes by the next annual meeting.[36] The board evaluation statement should inform the re-election of the governance committee chair and other committee members.

Training and Development of Board Evaluation Providers

Standards, accreditation and professional practices for board evaluation providers should be developed, published and maintained. A code of conduct and practice should be independently developed and published, with oversight and monitoring mechanisms.[37] Membership in a professional group of independent board evaluation providers, and conformance by firms and individuals who subscribe to the code, should be published. Companies retaining independent board evaluation providers should draw upon those association members and firms who subscribe to this code, and should comply with the code in retaining board evaluation providers.

The code for board evaluation providers, developed on an EU or international basis, should address all of the following: independence, integrity, competence, continuing education, quality of service, advising client boards, client property, confidentiality, conflicts of interest, fees, dispute resolution, withdrawal of services, and monitoring and enforcement.[38]

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[35] Publicizing these items would increase transparency and may address professionalism of offerings and providers, including viewing external board evaluations as a viable business model by professional service firms and independent advisors.
[36] This concept of advisory resolution, along with the concept of assurance, in respect of the board evaluation statement, were first introduced in the draft Walker report (2009), supra note 15, at paragraphs 4.31 and 4.32, pages 58-59.
[37] This would address concerns of lack of consistency among service providers. A similar proposal for a Code of Conduct was also proposed by Sir David Walker for compensation consultants.
[38] Since corporate governance has been developing into a discipline over the last fifteen to twenty years, resistance and disparagement has occurred – the most famous of which has probably been Lord Conrad Black, coining the term "governance zealots," and by others using the more charitable terms "cottage industry." Governance advisors – and in particular board evaluation providers – should be subject to rigorous professional standards, as are other professional advisors (e.g., legal, accounting, compensation, search). As countries and companies increasingly move towards external board evaluations, it is in

Director associations that represent the interests of company directors (e.g., ecoDa, NACD, etc.) should not, directly or indirectly, undertake board evaluation services because of the conflict of interest in assessing members (boards and individuals) who provide non-evaluation related membership and other service fees to support the associations. The expertise of director associations, however, should be sought in developing the code, along with the expertise of monitoring bodies, academe and other professional member associations (e.g., accounting, legal, remuneration, risk, and secretarial).

(9) Should disclosure of remuneration policy, the annual remuneration report (a report on how the remuneration policy was implemented in the past year) and individual remuneration of executive and non-executive directors be mandatory?

Yes, disclosure should be mandatory for all three elements pertaining to executive and non-executive director remuneration.

One key responsibility of a director's fiduciary duty is to ensure sound oversight of the business strategy. Having a robust approach to executive remuneration policy, reports and implementation is a demonstration of sound fiduciary oversight. Sound work in this area helps executive retention and alignment with shareholders.

Establishing mandatory disclosure is appropriate because it:

i. Sets an equal playing field for all listed organizations;

ii. Mitigates the first mover disadvantage of organizations adopting better governance practices; and

iii. Allows shareholders the opportunity to compare key executive remuneration practices between companies and make better-informed investment decisions.

Executive and non-executive director compensation is a critical component to ensure that appropriate executive behaviours are aligned to the organization's risk appetite and strategy. Mandatory disclosure of the remuneration policy, annual remuneration report and individual remuneration of the executive and non-executive directors provides shareholders with a necessary level of transparency to evaluate the effectiveness of the board's decision-making process relative to the remuneration platform.

Disclosing the organization's remuneration policy provides shareholders with a description of the intention of the remuneration plan. The remuneration policy should disclose to shareholders a description of the executive remuneration principles and objectives, as well as capture the spirit of the business strategy, compensation elements, peer group and target pay positioning. The policy should establish a foundation in which the shareholder may assess the desired executive

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companies' interests to retain advisors who are subject to professional standards. The Commission has an opportunity to lead and support this development.

behaviours that the board wishes to reward and how well the remuneration outcomes align to the organization's business strategy.

The annual remuneration report should be mandatory as it enables the organization to describe how the outcomes of the executive remuneration platform aligned and supported the remuneration policy. This report should discuss the purpose of each element of compensation and illustrate how it links remuneration to organization performance. The report provides the opportunity to discuss the definitions of performance (i.e., financial, operational, etc.) and how remuneration outcomes are generated for the executive. The detail should reinforce to shareholders how the board arrived at the remuneration outcomes and justify the appropriateness and competitiveness of the executive remuneration. Finally, the report enables organizations to describe how pay as well as pay policies align to longer-term risk.

The mandatory disclosure of executive and non-executive remuneration for directors will help organizations communicate to shareholders the results of the remuneration policy and program. Disclosing individual remuneration informs shareholders that the compensation plans align executive behaviours to the business strategies in which shareholders are investing. Disclosure reinforces to shareholders that pay is aligned to performance, and emphasizes the quality of the board's decision-making and that they are meeting their fiduciary duty.

There are few negative impacts that can be imagined from making disclosure mandatory. A well designed and disclosed pay for performance executive remuneration platform will reinforce to shareholders that the board of directors has in-fact achieved its fiduciary duty to implement properly an executive remuneration program that aligns pay to performance and shareholder expectations.

(10) Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?

Yes, it should be mandatory to put the annual remuneration report to a vote by shareholders. Many organizations in countries like Canada and the United States originally opposed this practice. More recently, many companies recognize the potential value of such votes and although it may be imperfect they seem accepting of the practice. This "say on pay" practice has provided investors and shareholders with a voice on an important governance matter.

Say on pay is an attempt by regulators to put the shareholder's voice in the boardroom. Establishing a mandatory vote is appropriate because it:

i. Sets an equal playing field for all listed organizations;

ii. Frequently stimulates a proactive dialogue between the organization and shareholders, which helps strengthen the board's relationship with shareholders;

iii. Allows shareholders the opportunity to indicate their support for or against the executive remuneration; and

iv. Mitigates “influencer” good governance and shareholder activist organizations from creating a market disequilibrium. More specifically, when these influencer good governance groups add a new policy to an agenda, history shows that large market cap organizations tend to be targeted first for adopting a new policy, which tends to create a cascading effect of mid-and small cap organizations adopting the policy over a multi-year period thereafter throughout an exchange.

While adopting “say on pay” should be mandatory, it is important to note that the vote should be a non-binding vote, so that the board continues to oversee the overall fiduciary responsibility for the company. For the exchanges to remain competitive globally from a compliance and cost perspective, two policies that might exempt some organizations from the mandatory vote should be considered:

i. Granting a grace period to adopt the shareholder vote for new-IPO organizations; and

ii. Establishing a threshold market cap.

In markets that have adopted “say on pay,” as a non-binding advisory vote, the policy has improved organizational transparency and disclosure. The policy has helped improve investor relations by improving communication and dialogue between directors and shareholders. Academic research has found that the effect on “say on pay” in the UK has been greater penalties for poor performance, and specifically the removal of controversial pay practices and the ex ante removal (e.g., advance scrutiny by the board or compensation committee advising their removal) of poor practices prior to the “say on pay” vote, for those firms experiencing low dissent. Regression tests have documented an increase in pay-for-performance sensitivity, including in firms experiencing high dissent and excess CEO pay before the say on pay legislation was introduced.[39]

In addition, for those organizations that have adopted “say on pay,” the policy has further shaped the work of boards (see parenthesis in immediately preceding paragraph for example). Specifically, the remuneration committee’s activities have often become more rigorous in analyzing the executive remuneration design. Boards that have adopted “say on pay” tend to focus more on the pay for performance analysis on both a relative and absolute basis. As a result, executive pay designs have tended to further integrate performance results into actual executive remuneration payouts, therefore better aligning pay with shareholder interests. Boards also tend to focus more on both the level and time horizon of risk associated with remuneration outcomes, and if the plan designs incentivize excessive risky behaviour outside of the organization’s “say on pay” risk appetite.

Lastly, “say on pay” tends to establish a market threshold on executive remuneration policies, such as excessive severance, perquisites, pensions and income tax payments. For example, in the

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[39] See Ferri, Favrizio, and Maber, David A., “Say on Pay Votes and CEO Compensation: Evidence from the UK,” Social Science Research Network, available via one-click download online at SSRN: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1420394>.

UK and USA normalized parameters around severance have now surfaced regardless of the industry or size of the organization.

While “say on pay” is a blunt instrument (a no vote does not provide the level of detail to the board on what specifically shareholders disapprove of), it has not tended to slow down the rate of change or scale back executive remuneration levels. An unintended consequence of adopting a shareholder vote on executive remuneration is that boards of directors may choose to not change a plan design once a yes vote is achieved, despite a potential change in business strategy. Another shortcoming of adopting the shareholder vote is that regardless of the increased transparency, disclosure and shareholder communications surrounding executive remuneration, shareholders will never have the level of detail on the business strategy and competitive landscape that the board has; therefore, the shareholder will continue to vote with incomplete information.

Further considerations:

With mutual funds holding a significant percentage of the shareholder votes, investors in mutual funds should understand how their fund manager is voting in order to gauge if the votes are in the best interests of improving executive remuneration. Are the voters conflicted, as voting “no” may lead to weaker relations between organizations and certain institutional shareholders? Given an environment with mandatory shareholder votes on executive remuneration, regulators may also need to establish a policy that mutual funds be required to disclose their “say on pay” votes.[40]

While the shareholder vote and mandatory disclosure are good for shareholders and governance practices, some further improvement to required disclosure should also be considered. To date, publicly traded organizations on some exchanges are required to disclose the firm retained as the independent executive compensation advisor, as well as the services they conducted and the fees received for the work. While this movement helps shareholders evaluate the independence of the executive remuneration advisor, the disclosure has not gone as far as to say if the board adopted its independent advisor’s recommendations in full or in part. This may be an area worthy of future review.

[40] See, e.g., Aguilar, Luis A., “An Inflection Point: The SEC and the Current Financial Reform Landscape,” Harvard Law School Forum on Corporate Governance and Financial Regulation (blog), available at: HLS: <http://blogs.law.harvard.edu/corpgov/2011/07/09/an-inflection-point-the-sec-and-the-current-financial-reform-landscape/>:

> “There seems to be real evidence that say-on-pay is one catalyst to increasing shareholder engagement more broadly. …
> …the Dodd-Frank Act requires disclosures from investment managers regarding how they are using their voting power in say-on-pay votes... The Commission is currently working on the final rules to implement this disclosure by investment managers, and it is my hope that the rules provide investors with fulsome and useful information.”

(11) Do you agree that the board should approve and take responsibility for the company's 'risk appetite' and report it meaningfully to shareholders? Should these disclosure arrangements also include relevant key societal risks?

Background: The term "risk appetite" has much confusion surrounding it.[41] So much so that the 22 countries who agreed to adopt ISO 31000 risk management guidelines[42] in 2009 decided not to use it anymore. It would be better to ask: "Do you agree that the board should review and approve the company's risk criteria[43] as developed and used by management?"

The second part of the first question is a bit more problematic, i.e.: "report it meaningfully to shareholders?"

The use of the term "it" perpetuates the idea that an organization can have a single "risk appetite" which is just not correct, since it would depend on the objective being evaluated and on the expected rate of return.

"Meaningfully" implies a level of detail that would be helpful to readers. Such detail (assuming now we are using "risk criteria"), while helping some readers, may disclose more than is good for the organization due to disclosing competitive information. "Risk criteria" is very helpful to management, and the board should be aligned and agree to such measures, but there comes a point at which time disclosure could lead to loss of revenue, lawsuits for failed initiatives and a distraction to readers. There are many other key aspects of managing the business (e.g., approval limits, technical specifications, credit scoring models, trade secrets) that are not disclosed and that is why shareholders should appoint qualified directors to provide the necessary board oversight.

In summary: The wording should be changed to avoid using the contentious term "risk appetite" and should not be disclosed to shareholders. Instead the strategic objectives and initiatives of the corporation should be provided to shareholders so that there is a clear understanding of what is being envisioned and what is being done to achieve such goals.

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[41] Prior to the publication of COSO 2004, the terms "risk appetite" and "risk tolerance" were used interchangeably by risk managers and the attendant literature. However, COSO 2004 attempted to define these terms differently: the former as being a higher level single view of risk, with "risk tolerances" being a lower level more specific definition of tolerable risks. Attempting to define a single statement for an organization for its "risk appetite" has proven difficult or impossible, often leading organizations to define numerous sub definitions for each of the many types of risks.

[42] ISO 31000 Risk management – Principles and guidelines were issued in 2009 by the International Organization for Standardization. This is the first true international standard for risk management and has been widely adopted. It encompasses much of the concepts and practical reality of the well accepted AS/NZ 4360 Risk Management Standard.

[43] ISO 31000 describes "risk criteria" (section 5.3.5), which represent the definitions and means by which an organization's management (and board) would evaluate how critical the various sources of risks are as part of their risk assessments and treatment processes.

In regards to the second question, the term "societal risks" is not well understood. It appears to be a new term promulgated by the World Bank[44] to bring focus on social issues. While this is valid and laudable, it is a social and government construct rather than one for corporations per se.

As is pointed out in the Green Paper (at page 10), "activities that might potentially generate such risks are subject to specific sectoral legislation and to monitoring by competent authorities." It is the responsibility of governments and social agencies to focus on "societal risks" and where appropriate provide laws and regulations and other guidelines and motivations for the betterment of society. This is not part of a public corporation's mandate, while they may well choose to address some societal issues either for altruistic reasons or for better brand image and reputation. It is the accountability of corporations and of their boards to ensure compliance with laws and regulations and to protect and enhance the brand and reputation. The latter may well be a strategy that is assisted by advancing societal risk management.

There can be much debate on exactly what are "societal risks" from the viewpoint of a corporation. One can surmise that the term includes environmental damage, which is a bad thing and harms the environment. Hopefully, there are laws that address this and must be observed. However, it is unlikely, for example, that food processing companies would define their processed food products as a societal risks, even though the medical profession considers their products to be a major cause of obesity, diabetes and heart problems. This example is provided to illustrate that defining and getting agreement on what are "societal risks" will require much effort and will not be easy to implement in the short term.

In conclusion, we do not think that this idea is practical and instead "societal risks" need to be addressed through normal risk management that would disclose risks to regulatory compliance and reputation. Of course, all major risks, both financial and non-financial, that would impact the stakeholders' views of the company should be disclosed to achieve regulatory compliance and to protect against future lawsuits from investors in all regulatory filings, such as prospectuses etc.

(12) Do you agree that the board should ensure that the company's risk management arrangements are effective and commensurate with the company's risk profile?

One of the key priorities of a board is to ensure that risk management arrangements are effective.[45] This is often referred to as oversight of risk management.[46] So the statement "Do

[44] "Social Risk Management – The World Bank's Approach to Social Protection in a Globalizing World" by The Human Development Network, The World Bank, 2003.
[45] An example of regulatory requirements for board regarding risk oversight is the Ontario Securities Commission "National Policy 58-201 Corporate Governance Guidelines," section 3.4, supra note 9, which requires:
"The board should adopt a written mandate in which it explicitly acknowledges responsibility for the stewardship of the issuer, including responsibility for: …
(b) adopting a strategic planning process and approving, on at least an annual basis, a strategic plan which takes into account, among other things, the opportunities and risks of the business;
(c) the identification of the principal risks of the issuer's business, and ensuring the implementation of appropriate systems to manage these risks;"

you agree that the board should ensure that the company's risk management arrangements are effective." is correct and should probably stay at that, but see below for the subsequent proposed phrase.

The phrase "commensurate with the company's risk profile." is laden with potential confusion and misinterpretation due to the term "risk profile." A corporate risk profile is a periodic documentation of the key risks to an organization to achieving its stated business objectives over a specified future time period.[47] Risk profiles[48] are like balance sheets, i.e., the status of a company's risk exposure after taking into account its strategic objectives, its context, and its treatment of risks.

Since risk profiles, by definition, are where a company is at, then the risk management arrangements will always be commensurate with the profile, i.e., its derivative. A more meaningful question might be "Do you agree that the board should ensure that the company's risk management's arrangements are commensurate with the company's strategy and risks." The phrase "and commensurate with the company's risk profile" is therefore redundant as "ensuring the risk management arrangements are effective" covers the intention of this last statement.

<u>Shareholders</u>

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(14)	Are there measures to be taken, and if so, which ones, as regards the incentive structures for and performance evaluation of asset managers managing long-term institutional investors' portfolios?

Although Questions 14 to 16 are phrased in terms of institutional investors, they are equally relevant, and perhaps more so, in relation to individual investors.

Institutional investors have both the resources and the power to negotiate asset management contracts that protect their interests. For this reason, securities legislation has traditionally focused on the protection of individual investors, who lack the requisite resources and clout.

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[46] "The oversight of the enterprise risk management process employed by an organization is one of the most important and challenging functions of a corporation's board." See page 51 of Fraser, J., and Simkins, B.J., Eds., *Enterprise Risk Management – Today's Leading Research and Best Practices for Tomorrow's Executives* (Toronto: Wiley, 2010). See also "Effective Enterprise Risk Oversight: The Role of the Board of Directors" (2009) COSO.

[47] See Fraser, J., and Simkins, B.J., Eds., *ibid*, at page 171.

[48] Other definitions of a risk profile include: ISO defines a risk profile as "a description of any set of risks" and risk as "effect of uncertainty on objectives" (ISO 31000 2009). HM Treasury's The Orange Book: Management of Risk Principles and Concepts (October 2004) defines a Risk Profile as "the documented and prioritized overall assessment of the range of specific risks faced by an organization." The 2002 Risk Management Standard produced by the Institute of Risk Management (UK) and the Institute of Insurance and Risk Managers (UK) defines a Risk Profile thus in section 4.5: "The result of the risk analysis process can be used to produce a risk profile which gives a significance rating to each risk and provides a tool for prioritizing risk treatment efforts. This ranks each identified risk so as to give a view of the relative importance."

That the European Commission should feel compelled to ask this question seems to indicate that it is uneasy with how institutional investors are discharging their responsibilities.

In the quest for solutions, the Green Paper focuses on how to improve the relationship between institutional investors and asset managers. In our view, a more fundamental approach would involve questioning the governance of institutional investors, such as pension funds. The Green Paper does not seem to address this vital issue. Indeed, the issue is sufficiently important to warrant its own consultation paper.

The Green Paper asks the question whether additional measures could be introduced to ensure congruence between the interests of institutional investors and those of asset managers. We believe that it would be more productive to recognise that there are inherent conflicts of interest between investors, both institutional and individual, and asset managers. The implication is that, rather than pursue the illusory objective of ensuring alignment of interests, the EU should focus its efforts on ensuring that conflicts of interest in the management of client portfolios are resolved in favour of the client. We expand on this subject in our answer to Question 16.

The Green Paper is correct in its assessment that relative performance evaluation can encourage herd behaviour and a short-term focus. We would add that it could also encourage excessive risk taking. Suppose the performance measurement period is nearing its close and an asset manager is badly lagging its benchmark. The rational course of action for this manager would be to redeploy the client's portfolio into the most volatile stocks available. If the gamble works and the stocks shoot up, the manager may actually end up outperforming the benchmark. If the gamble fails and the stocks plummet, the manager will be no worse off because it was badly lagging the benchmark to begin with. While rational for the manager, this course of action is unconscionable because it exposes the client to more risk than it had bargained for.

Short-termism is also encouraged by some practices, which are the norm in the asset management industry. There is considerable evidence that stock prices are unpredictable in the short-term. If so, short-term performance has more to do with luck than with skill. Yet, institutional investors typically meet with asset managers on a quarterly basis to review the previous quarter's results. The tyranny of the quarterly meeting has much to answer for.

We suggest that investors, asset managers and indeed the market as whole would gain from refocusing industry practices, including the evaluation of asset managers, on the long term, by which we mean ten years or more. This raises the question how best to achieve this result. We believe that the answer involves consideration of the standard of conduct that should apply to institutional investors, their accountability to their constituents and ultimately their mode of governance.

(15) Should EU law promote more effective monitoring of asset managers by institutional investors with regard to strategies, costs, trading and the extent to which asset managers engage with the investee companies? If so, how?

The Green Paper refers to asset managers as "stewards" of the investee companies. Stewardship, a concept going back to the Middle Ages if not earlier, indeed hits the nail right on the head, although we tend to think of asset managers as being stewards for their clients, i.e., institutional and individual investors, rather than for the investees. Indeed, the investee companies, in turn, are stewards for the asset manager, rather than the other way round.

In our view, the stewardship quality of an asset manager is far more important than the factors mentioned in the question – strategies, costs, trading and engagement with investees. The question, then, is how to assess stewardship quality.

The volume of research effort on the stewardship quality of asset managers and its determinants is not commensurate with the importance of the subject. We recommend that the EU encourage more research in this area.

Morningstar, an independent provider of investment fund research, assigns stewardship grades on the basis of five main factors:

i. The corporate culture of the asset manager – this is assigned the heaviest weight;

ii. The quality of the fund's governing body, e.g. its board of directors;

iii. The fees and expenses charged by the asset manager to the fund;

iv. The motivation of the individuals managing the portfolio, with particular reference to the size of their personal investment in the fund and the structure of their remuneration, including the manner in which their bonus is determined; and

v. The regulatory requirements of the asset manager.

Independent research has suggested that high stewardship grades are correlated with superior fund performance.

The evaluation of an asset manager's stewardship quality is hampered by the lack of information. For example, in most jurisdictions, the disclosure of the information in (iv) above is not mandatory.

As an initial step towards improving the stewardship quality of asset managers, we recommend that the disclosure of the relevant factors, such as those listed above, should be made mandatory.

In the longer term, the EU should consider requiring asset managers to obtain a stewardship grade as a precondition to offering their services. For now, we leave open the question as to who should assign the stewardship grades and how.

(16) Should EU rules require a certain independence of the asset managers' governing body, for example from its parent company, or are other (legislative) measures needed to enhance disclosure and management of conflicts of interest?

As we suggested earlier, the relationship between asset managers and investors is inherently conflictual in many respects. High priority should be given to dealing with this issue. In the first instance, asset managers should be subject to a standard of conduct that makes it clear that, in managing client portfolios, they owe their primary loyalty to their clients, in whose best interests they should always act. EU rules should include severe penalties for transgression of the standard of conduct.

Organizational controls would also be helpful in ensuring that conflicts of interest are always resolved in favour of the client. The asset manager should be required to take all conflicts of interest to an independent party, which would be charged with ensuring that the issue is resolved in the client's favour. That independent body could, for example, be:

i. The governing body of the asset manager, provided it includes a majority of independent directors and an independent chairman;

ii. If the client is an investment fund, the governing body of the fund, provided it is independent; or

iii. An independent body dedicated to the resolution of conflicts of interest.

Canada has opted for solution (iii). All publicly distributed investment funds in Canada are now required to have an Independent Review Committee whose role is to examine conflicts of interest referred to it by the asset manager and to provide a decision to the latter.[49] In some cases, the Committee's decision is binding. In other cases, the Committee only has the authority to make a recommendation. It would be helpful to the EU to monitor the progress of Independent Review Committees in Canada and determine if the model might apply in the EU.

(18) Should EU law require proxy advisors to be more transparent, e.g. about their analytical methods, conflicts of interest and their policy for managing them and/or whether they apply a code of conduct? If so, how can this best be achieved?

Unless proxy advisory firms are prepared to self-regulate by adopting an industry-wide code of conduct, EU law should require proxy advisors to be more transparent.[50] There are two main reasons for enhanced transparency.

i. *Influence* Although it has yet to be ascertained what percentage of votes proxy advisors can influence on either a routine or non-routine matter, taking into account just the number of institutional shareholders who disclose that they subscribe to a proxy advisor, it cannot be denied that the proxy advisory industry has the potential to influence a

[49] Fok Kam, André, *From Conflict to Trust: How Mutual Funds Manage Conflicts of Interest* (Toronto: Carswell, 2009).
[50] Millstein Center for Corporate Governance and Performance, Policy Briefing No. 2/Voting Integrity: Practices for Investors and the Proxy Industry (June 5, 2008), available online: Millstein <http://millstein.som.yale.edu/2008%2006%2005%20voting%20integrity2.pdf>.

significant block of votes. In addition to the potential to influence voting outcomes, there is consensus that proxy advisors are no longer merely "independent" experts evaluating corporate governance, but are in fact furtively shaping behaviour of market participants through their views on corporate governance best practices.[51]

ii. *Inaccuracies* There is convergence in the existing literature on the proxy advisory industry on the limited predictive power in the models of the proxy advisory industry and on the frequency of inaccuracies underpinning the proxy advisory firms' recommendations.[52] The problem with this lack of transparency at the proxy advisory firm level is that it does not provide scholars, issuers and investors with an opportunity to question the quality of the data, analyze voting recommendations, and potentially point out inaccuracies in proxy advisors' analysis.

Our recommendations:

Disclose any Conflict of Interest

- Whether self-regulated or legislated, proxy advisors should disclose, review, manage and mitigate all potential conflicts (e.g., consulting services; financial stakes; record-keeping services; and voting platforms). The disclosure of potential conflicts of interests would not only address conflicts of interests with the provision of a multiplicity of functions to issuers, but it would also address potential conflicts of interest between affiliates and subsidiaries of the proxy advisory firms. The idea is that if institutional investors were made aware of the concerns surrounding the quality and creditability of the voting recommendations and conflicts of interests, they would demand that proxy advisory firms be more transparent or switch to a firm that is. Alternatively, institutional investors will rely more on their own discretion when reviewing a proxy advisor's recommendations.

Research Sourcing

- When providing a recommendation, proxy advisors should be required to list the name and contact details of the lead analyst and key team members.

- All sources consulted to produce a report should be listed (e.g., public information, private information, media reports). As part of this sourcing requirement, a proxy advisory firm should be required to disclose whether an issuer's management or board were consulted.

Method of Challenging Adequacy of Research / Erroneous Data, Incomplete Facts or Inaccurate Data Analysis

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[51] Jennifer G. Hill, "Regulatory Show and Tell: Lessons from International Statutory Regimes" (2008) 33 Del. J. Corp. L. 819 at page 822.
[52] Center on Executive Compensation, *A Call for Change in the Proxy Advisory Industry Status Quo: The Case for Greater Accountability and Oversight* (Washington: Center for Executive Compensation, January 2011).

- Issuers being assessed ought to have a mechanism to challenge the recommendations made by proxy advisory firms.
    - On request, an issuer should be able to receive a copy of a proxy advisory firm's report.
- A public agency (e.g. securities commission) ought to be able to request, audit and challenge any voting recommendation.

(19) Do you believe that other (legislative) measures are necessary, e.g. restrictions on the ability of proxy advisors to provide consulting services to investee companies?

While restrictions on the ability of proxy advisors to provide consulting services to investee companies are not necessary, there are other legislative measures that might be useful.

Restrictions on the Ability of Proxy Advisors to Provide Consulting Services to Investee Companies

It is not known whether the investment objectives of a proxy advisory firm's affiliate may interfere or override a proxy advisory firm's voting recommendations. Among other measures to minimize conflicts of interest, many proxy advisory firms have erected firewalls among consulting and other businesses by floating subsidiaries for non-rating services. Without evidence that proxy advisory firms are acting on conflicts of interest, it is not necessary to restrict the ability of a proxy advisory firm to provide consulting services. This does not, however, mean that proxy advisory firms need not be much more forthcoming in disclosing their conflicts of interest and how they manage their conflicts of interest.

Institutional Investor Regulation

Institutional investors, as the only customers of the proxy advisory firms, arguably have the necessary clout to demand better governance of the proxy advisory firms. Accordingly, along with disclosing their proxy voting record on a functional website and keeping it up-to-date, institutional investors ought to disclose how they use proxy advisory firm(s).[53] Some institutional shareholders rely on proxy advisors to analyze, vote and organize all its proxy votes. Other institutional shareholders do not seem to use proxy advisory firms at all. How and to what extent institutional investors rely upon proxy advisory firms should be disclosed with specificity (e.g., is there an internal team; does it have a customized voting guideline with the proxy advisory firm; what services supplied by the proxy advisory firm does it rely upon?). It would further be advisable to have institutional investors disclose what internal controls they have in place to ensure that these services are being carried out in a timely and accurate way.

[53] Carol Hansell & Robert Murphy, "The Role of the Advisory Firm: What Directors Need to Know" (Paper presented to the Australian Institute of Company Directors MasterClass, Sydney, Australia, 8 March 2011) online at DWPV: <http://www.dwpv.com/shareholdervoting/media/TheRoleoftheProxyAdvisoryFirm.pdf> .

Increased Competition

The proxy advisory industry is marked by the absence of competition, which naturally raises apprehension about proxy advisory firms misusing their market power. Legislative action might be needed to encourage more competition between existing proxy advisory firms and new entrants to the market. Reforms aimed at increasing competition are, however, complicated by the fact that size and market recognition may be higher barriers to entry than regulatory status.[54]

(20) Do you see a need for a technical and/or legal European mechanism to help issuers identify their shareholders in order to facilitate dialogue on corporate governance issues? If so, do you believe this would also benefit cooperation between investors? Please provide details (e.g. objective(s) pursued, preferred instrument, frequency, level of detail and cost allocation).

This question will be addressed in three parts.

(a) Do you see a need for a technical and/or legal European mechanism to help issuers identify their shareholders in order to facilitate dialogue on corporate governance issues?

While we acknowledge the importance of the ability of issuers to communicate with shareholders, “identifying” shareholders is critical as a matter of public policy because doing so improves the integrity of *voting* procedures. One of the central motives for identifying voters seems to be the prevention of over-voting and ‘empty’ voting. The present Green Paper, in focusing on the importance of “communication” between issuers and their shareholders, seems essentially to ignore the question of corporate democracy, relegating it to footnotes.

The ability to communicate effectively with shareholders, and for shareholders to coordinate amongst themselves, enables meaningful dialogue and engagement with and among them, in particular, in elements of corporate governance. More however needs to be done to understand the problems of, e.g., over-voting, and the extent to which shareholder identification is a suitable remedy to those problems.

Shareholder identification and communication is a serious issue. Given high annual rates of shareholder turnover, and given the roles of various intermediaries (including especially banks and brokerages), the technical challenges inherent in identifying and communicating with shareholders prior to an issuer’s Annual Meeting are substantial. Some EU member states (e.g., Spain) have made significant progress in this direction. We have no specific suggestions in this regard, but we urge the Commission to focus on the question of establishing mechanisms aimed specifically at providing issuers with information necessary to improving the integrity of voting procedures, in addition to focusing on the more general question of shareholder communication.

(b) If so, do you believe this would also benefit cooperation between investors?

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[54] Paul Rose, “On the Role and Regulation of Proxy Advisors” (2010) 109 Mich. L. Rev. 62.

This depends very much on the particular mechanism chosen. In principle, a mechanism adopted to facilitate communication between issuers and shareholders in the interest of more rigorous voting procedures might well benefit cooperation between investors, and that might well be a good thing.

(c) Please provide details (e.g. objective(s) pursued, preferred instrument, frequency, level of detail and cost allocation).

The key objective should be to improve the integrity of shareholder votes, by clarifying share ownership. The goal here should be to reduce the prevalence of over-voting, 'empty' voting, and other attempts to 'game' the system of shareholder democracy.

(21) Do you think that minority shareholders need additional rights to represent their interests effectively in companies with controlling or dominant shareholders?

We agree that minority shareholders should have board representation, given the difficulties identified with "comply or explain" in this instance; the difficulty of (or inability) of engaging minority shareholders; and the approval of related party transactions. A "significant" (or "dominant" or "controlling," however defined) shareholder may be defined as a shareholder with the ability (either de facto or de jure) to exercise a majority of the votes for the election of the board of directors. A significant shareholder could be an individual, a group of individuals (e.g., a family, a voting trust, etc.), or a corporation.

If a corporation has a significant shareholder, we recommend that an appropriate percentage of board seats be reserved for minority shareholder representation. These directors selected by minority shareholders (i) should be reasonably perceived to be independent of management *and* the significant shareholder; (ii) should pass all black line tests of independence in the relative jurisdiction; and (iii) should not have any relationship or association with the corporation that would give rise to independence concerns (from a reasonable person (objective) perspective, not in the subjective judgment of those directors who are neither independent from the significant shareholder nor management).

As to what the percentage of board positions that are allocated to minority shareholder representation should be, we recommend that this percentage should fairly reflect the investment in the corporation by shareholders other than the significant shareholder.

We also recommend that if the mandate of the board, any principal committee of the board, or any board or company leadership role (e.g., the chair of the board, the CEO, or a chair of any principal committee) is limited in any way by the significant shareholder, that full, true and plain disclosure be made. In companies with a significant shareholder, disclosure should be made of the powers, rights and responsibilities of the significant shareholder, in a similar manner.

(22) Do you think that minority shareholders need more protection against related party transactions? If so, what measures could be taken?

A related party transaction is a conflict of interest between the related party (e.g., a control person, a significant shareholder, an officer, or a director of the corporation) and the corporation itself. If the board of directors does not take all appropriate action in light of the conflict, or shareholders (all shareholders, including minority) do not have full and complete knowledge of, or the opportunity to approve, ex ante, the transaction, the result could be self-dealing and appropriation of monies or opportunities by the related party at the expense of the corporation and/or minority shareholders.

Specific and precise guidance should therefore be offered to companies in respect of related party transactions, based on principles of transparency, clarity, independence of decision-making, independence of advice, and approval by all shareholders of the corporation.

The rights of minority shareholder to board representation has been addressed in the question above. So far as the treatment of the related party transactions by the board, the following steps are recommended:

i. A disclosed means to define, identify and manage the conflict of interest, at the board level;

ii. The establishment of a committee of directors who are deemed independent of all related parties, with disclosure of this committee's remit;

iii. The retention of independent expert opinion on nature and effect of the transaction on minority shareholders (Green Paper, at page 18);

iv. The retention of records and documentation of decision-making;

v. A mechanism for minority shareholder coordination and engagement of the committee in (ii);

vi. A recommendation to shareholders by the committee (ii), with supporting rationale; and

vii. The opportunity to approve the related party transactions by shareholders at a General Meeting (Green Paper, at page 18).

To assist the Commission, the Canadian Securities Administrators, in December 2008, shortly after the height of the Global Financial Crisis, proposed the following at Principle 6 – Recognize and manage conflicts of interest:[55]

[55] This proposal was later withdrawn, given the financial crisis two months earlier. See <http://www.osc.gov.on.ca/en/26274.htm>. See Request for Comment – Proposed Repeal and Replacement of NP 58-201 *Corporate Governance Guidelines*, NI 58-101 *Disclosure of Corporate Governance Practices*, and NI 52-110 *Audit Committees* and Companion Policy 52-110CP *Audit Committees* Request for Comment: Proposed Repeal and Replacement of National Policy 58-201 Corporate Governance Guidelines, available at OSC: <http://www.osc.gov.on.ca/documents/en/Securities-Category5/rule_20081219_58-201_rfc.pdf>.

"Principle 6 – Recognize and manage conflicts of interest

An issuer should establish a sound system of oversight and management of actual and potential conflicts of interest.

Commentary

Conflicts of interest may arise in various situations, for example, when:

(a) there is a significant divergence of interests among shareholders or their interests are not completely aligned;
(b) one or more directors cannot be considered impartial in connection with a proposed decision to be made by the board;
(c) a contract, arrangement or transaction is entered into between an issuer and a control person or significant shareholder; or
(d) an issuer makes a decision or enters into a contract, arrangement or transaction that will benefit one or more of its officers or directors.

An issuer should have practices in place to identify, assess and resolve actual and potential significant conflicts of interest. Those practices should allow issuers to assess all the circumstances necessary to determine if directors, officers and employees have acted honestly and in good faith, and in the best interests of the issuer.

Examples of practices

General practices

The objective of this principle can be achieved in a number of ways, including by:

(a) having practices for:

    (i) identifying situations, decisions, contracts, arrangements or transactions where an actual or potential significant conflict of interest could arise;
    (ii) reviewing and assessing situations, decisions, contracts, arrangements or transactions that could put directors or executive officers in an actual or potential conflict of interest;
    (iii) submitting to the board the prior declaration by directors of their interest in any situations, decisions, contracts, arrangements or transactions;
    (iv) keeping records of any situations, decisions, contracts, arrangements or transactions where an actual or potential conflict of interest arises; and

(b) establishing an ad hoc or standing board committee to carry-out these practices, such committee to consist of directors that are not directly or indirectly interested in the matters being discussed or considered; and

(c) obtaining independent advice on the situation, decision, contract, arrangement or transaction.

Practices related to ad hoc or standing board committee

Where an issuer has established an ad hoc or standing board committee, design that committee to:

(a) be composed of directors who are not interested in any matter being discussed or considered;

(b) have terms of reference that clearly sets out its roles and responsibilities; and

(c) have the authority to engage and compensate any internal and external advisor that it determines to be necessary to permit it to carry out its duties."

(23) Are there measures to be taken, and is so, which ones, to promote at EU level employee share ownership?

In short, no. The desirability of employee ownership ought not to be prejudged by regulators. The question of motivating employees is a fundamental challenge faced by all companies, and various companies will arrive at different solutions. There is far too little consensus regarding the best combination of salary, bonuses, equity, and non-financial rewards such as status or public recognition. Nor is it likely that there is one right solution that is best for all organizations. Further, there is insufficient evidence of social benefit from employee share ownership to make such ownership a policy objective. Finally, there is a risk that any move taken to promote employee share ownership will inadvertently result in overinvestment in single firms by employees who ought, instead, to be encouraged to hold diversified investment portfolios. At most, the Commission should encourage issuers to take a thoughtful approach to the issue, such as neither to discourage nor over-encourage employee share ownership.

The Green Paper (at page 18) notes that employees' involvement in the affairs of the company may take the form of participation in the board, as well as share ownership. Although employee participation on the board was not addressed in question 23, we offer some views.

There is merit in having employee representation on boards of directors, in the form of information, diversity and consultation. In the UK and Germany, employee representation occurs (in the form of executive and worker representatives). In Canada, large institutional shareholders,[56] credit unions, cooperatives,[57] and not-for-profit organizations[58] have board

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[56] In the Ontario Teachers Pension Plan board of directors, for example, four of nine directors are elected by the Ontario Teachers Federation (an association of employee/retiree teachers), with the chair of the board of directors jointly selected by the employee group and the provincial government. In the Ontario Municipal Employees Retirement System, another large pension fund, equal representation on the board of directors occurs between employer and employee/retiree members (seven members each).
[57] Financial and non-financial co-operatives have well-developed democratic processes enabling members to participate, via election, on the board.
[58] Medical staff; and faculty, staff and students often have board level representation within hospital and university boards of directors.

positions allocated, in varying degrees, to employee or member representation. We are not aware of any scholarship that boards of directors with employee representation are less effective or fail to meet their obligations. Providing that employee members act with a view to the best interests of the corporation, the benefits to employee membership on boards may include diversity,[59] information flow and worker commitment.

Monitoring and Implementation of Corporate Governance Codes

(24) Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?

The "comply or explain" model is generally an admirable regulatory framework for its flexibility; however, it is thought to be problematic in respect of controlled companies and minority shareholders (Green Paper, at page 17). In addition, more broadly, there could be greater guidance offered to all companies on improving the information quality of reporting within the "comply or explain" regime.[60]

Our recommendations:

i. That a robust and rigorous framework of "comply or explain" disclosure and assurance – including general, free-form and provision-by-provision responses – be developed that would assist companies, boards of directors and investors in providing, pressing for, and comparing responses.

There are opportunities for greater attention to, and development of, the "*explain"* plank of the "comply or explain" regime. At present, inadequate guidance could encourage uncertainty and low disclosure quality; defensiveness on the part of legal counsel; reluctance by boards of directors to press for increased disclosure and informative content; lack of consistency and quality in responses; and the inability to compare ambiguous or inadequate responses, efficiently and effectively.

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[59] The above examples offer opportunity to address board diversity (gender, ethnicity, age), as these types of boards (with employee member representation) are recognized for being diverse; and may bring skill sets such as human resources, community representation, industry knowledge and information technology, onto the board.

[60] See, e.g., "Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States" (September 2009), available at EU: http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf, at page 14, where "[o]nly 39 percent of all explanations on the reference corporate governance code are classified as sufficiently "informative"." See also, "Canadian Securities Administrators Staff Notice 58-306 2010 Corporate Governance Disclosure Compliance Review" (December 2010), available at OSC: <http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20101203_58-306_2010-corp-gov-disclosure.htm>, at page 3, where non-compliance with the disclosure requirements of the Corporate Governance Instrument was termed "unacceptable." See also the Green Paper, at page 19, where the overall quality of companies' corporate governance statements when departing from a code recommendation is "unsatisfactory," according the study, *ibid*.

ii. That, where departures are permissible in the first place, companies departing from the recommendations of corporate governance codes be required to explain themselves fully, via detailed, specific, clear, accessible and concrete reasons for the departure.

Insofar as departures from recommended code practices are concerned, departures reflects the sensible view that there should be a presumption in favour of recommended practice, without the assumption that no deviation could ever be justified. The Swedish model in particular (requiring disclosure of departure, disclosure of the reasons for departure, and disclosure of the alternative adopted) is very good (as identified in the Green Paper at page 19). Shareholders and potential investors deserve to know why a company has deviated from recommended practice. The requirement is also minimally burdensome, and allows for companies to seek out tailored governance solutions.

iii. That certain provisions within the "comply or explain" regime require compliance.

That being said, we do believe that a general preference for the "comply and explain" model is consistent with the view that, on some matters, compliance should simply be required. These matters where compliance is required should be identified within the enhanced disclosure "comply or explain" framework that we recommend in item (i).

The "comply or explain" model has the further benefit of helping to disseminate innovative governance practices. Since individual companies are expected to highlight and justify deviations from codes, this effectively puts the innovation into the public sphere, both for critique and for other companies to adopt and modify.

(25) Do you agree that monitoring bodies should be authorised to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary? If yes, what exactly should be their role?

Although the role and responsibilities of investors were not included in Question 25, we have addressed these in our response.

Our recommendations:

i. That "principles of stewardship" within a "comply or explain" regime – addressing communication, engagement, monitoring and enforcement – be developed and implemented for institutional investors.[61]

We note that the monitoring responsibility of shareholders is still largely unregulated. We believe that reluctance to commit time and resources on the part of investors (as identified in the

[61] *Ibid*, item one, "Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States," at pages 17-18.

supporting Green Paper study)[62] and free-rider issues may be addressed by strengthened disclosure rather than regulation. All institutional investors should be required to disclose voting policies and records, monitoring activities, enforcement practices, and the implementation of their corporate governance policy, via a "comply or explain" framework (similar to listed companies).

ii. That monitoring bodies be authorized to check the informative quality of the explanations of corporate governance statements and require companies to complete the explanations where necessary.

The role of monitoring bodies should be:

a. To act at all times in the public interest; to foster fair and efficient capital markets and confidence in their integrity; and to foster investor confidence;

b. To develop, and revise on a regular basis, the "comply or explain" disclosure framework recommended in Question 24 (at (i));

c. To foster complete and trustworthy corporate governance disclosure by companies;[63]

d. To provide <u>independent</u>[64] and appropriately <u>resourced</u>[65] oversight of the quality and completeness of the information provided by companies, not the decisional content itself;

e. To provide analysis and disclosure, based on (d), on a company- as well as aggregate basis,[66] to companies, to investors, and to other stakeholders;

f. To liaise with monitoring bodies within other Member States;[67] and

g. To have the authority to sanction companies in serious cases of non-compliance.[68]

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[62] *Ibid*, at page 13. UK Treasury Minister Lord Myners had described investors as "absentee landlords." (April 21, 2009, in a speech to the Association of Investment Companies).
[63] *Ibid*, at page 16.
[64] Monitoring bodies should have arms-length relationships from listed companies, including personnel, and rigorous conflict of interest guidelines. This might mean a cooling off period for former listed company employees working for monitoring bodies.
[65] Monitoring bodies should be staffed and compensated appropriately.
[66] Supra note 63, at page 16.
[67] The Green Paper refers (at page 20) to there being "great potential" for improving and extending the current exchange of best practices developed by monitoring bodies. We agree.
[68] See, e.g., Green Paper at page 20. The Commission might also consider that sanctions (monetary) in the most serious cases of non-compliance (as identified in the Green Paper as being done in Spain) be directed to funding of the monitoring body, rather than general revenue. Funding of monitoring activities could also be provided by listed companies, on an aggregate basis, providing strict conflict of interest guidelines were in place.

In conclusion, there is an opportunity for significant improvement for both institutional investors and monitoring bodies in respect of monitoring the "informative quality" (wording of question 25) of the explanations in the corporate governance statements The role and importance of monitoring bodies, however, is more important as they represent the wider public interest. This question is very important.

Conclusion

The undersigned individuals would once again like to thank the Commission Members for the opportunity to submit this comment letter in response to the public consultation and invitation for comments on the Green Paper on proposed corporate governance enhancements in Europe.

In summary, we support the spirit of these proposed corporate governance reforms, which seek to build trust in the single market and contribute to the competitiveness of European business. We believe the implementation of our recommendations would greatly strengthen this objective. Please contact us if we can be of further assistance.

Respectfully submitted,

Working Group on EU Green Paper: The EU corporate governance framework.

Member Biographies

Richard Leblanc is a lawyer, certified management consultant and Associate Professor of Law, Governance & Ethics at York University. He holds a PhD focusing on board of director effectiveness. He has published in leading academic and practitioner journals, advised regulators on corporate governance guidelines, and, as part of his external professional activities, has served as an external board evaluator and governance advisor for ASX, LSX, NYSE, NZ, NASDAQ and TSX companies, as well as in an expert witness capacity in litigation concerning corporate governance reforms.

John Bankes is Managing Director and owner of Artemis Management Group, a company specializing in investment banking services to small and emerging growth enterprises. Previously, John was a partner in a Toronto law firm and an investment banker with major investment firms in the US and Canada. John is a director of a number of listed companies, private companies and non-profit enterprises. He is a graduate of Queen's, York and Harvard Universities and has been an adjunct professor in corporate law at Osgoode Hall Law School. John has received awards for academic achievement (Osgoode Hall Silver Medal, Canada Council Doctoral Fellowship), for commitment to the non-profit sector (Bruce Bryden Award at York University, Royal Canadian Academy of the Arts Centennial Medal, Queen Elizabeth II Golden Jubilee Medal) and for community service (The Royal Life Saving Society Silver Medal). Among other positions, John is currently a member of

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André Fok Kam, CA, MBA, is a consultant to the financial services industry. Among other clients, he has advised the Task Force to Modernize Securities Legislation in Canada and the Investment Industry Regulatory Organization of Canada (IIROC) as well as fund managers and dealers. He has developed several courses for the IFSE Institute, the educational services arm of the Investment Funds Institute of Canada. He was previously an investment director at a major institutional investor where he acquired first-hand experience of investment products. André holds a BSc (Economics) with First Class Honours from the London School of Economics and an MBA from McGill University. He is a Fellow of the Institute of Chartered Accountants in England and Wales and a member of the Canadian Institute of Chartered Accountants.

André has served on the Board of Directors of fund managers and dealers and is a member of the Independent Review Committee of the Standard Life Mutual Funds and the Landry Morin Mutual Funds. He is the author of *From Conflict to Trust: How Mutual Funds Manage Conflicts of Interest*, published by Carswell in 2009. He is a regular contributor to *Advisor's Edge Report,* an industry publication.

John Fraser is the Senior Vice President, Internal Audit & Chief Risk Officer of Hydro One Networks Inc, one of North America's largest electricity transmission and distribution companies. He is a Chartered Accountant, a Fellow of the Association of Chartered Certified Accountants (U.K.), a Certified Internal Auditor, and a Certified Information Systems Auditor. He has over 30 years experience in the risk and control field mostly in the financial services sector, including areas such as finance, fraud, derivatives, safety, environmental, computers and operations.

John is currently the Chair of the Conference Board of Canada's Strategic Risk Council, a Practitioner Associate Editor of the Journal of Applied Finance, and a past member of the Risk Management and Governance Board of the Canadian Institute of Chartered Accountants. He is a recognized authority on enterprise risk management and has co-authored/co-edited academic papers/industry publications and a university text-book released in 2010: "Enterprise Risk Management: Insights and Analysis on Today's Leading Research and Best Practices."

Paul Gryglewicz is the Managing Partner at Global Governance Advisors and is a key member of the firm's Senior Leadership Team. He engages with Boards and senior management advising them in the areas of Executive Compensation, Human Resource Strategy and Corporate Governance. Paul's work incorporates leading edge governance practices, mitigates risk and educates key stakeholders on sophisticated compensation systems.

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Cynthia Hill is a recent JD graduate of Osgoode Hall Law School, where she placed in the top 5% of her graduating class, and was awarded prizes and recognition in corporate/commercial law, corporate governance and ethical lawyering. Cynthia holds an undergraduate Bachelor of Commerce degree, from Queen's University, where she was recognized for her leadership and community service. Cynthia will be fulfilling her articling requirements at a leading Canadian business law firm.

Chris MacDonald is Associate Professor of Philosophy at Saint Mary's University, and is currently a Visiting Scholar at the Clarkson Centre for Business Ethics and Board Effectiveness at the Rotman School of Management. He has published widely on business ethics, professional ethics, and ethical theory, as well as writing for magazines and trade publications. He has been called one of the "Top 100 Thought Leaders in Trustworthy Business Behavior" and has been declared one of the "100 Most Influential People in Business Ethics" three years in a row. He is the author of the world's most influential business ethics blog, at www.businessethicsblog.com.

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