

Message from the Chair – Michael Wilson

The Canadian Coalition for Good Governance: Improving governance – not imposing it

CCGG Annual Meeting

June 23, 2005

Good afternoon and welcome to the Second Annual Meeting of the Canadian Coalition for Good Governance. Your attendance here today confirms that governance remains an important issue not just for investors but also for issuers, auditors, lawyers and regulators.

Corporate governance has come a long way since the Coalition was established in May of 2003. The annual corporate governance scorecards published by the Globe and Mail Report of Business, Canadian Business Magazine and the Rotman School of Management have increased both the awareness of the corporate governance practices in Canadian corporations and the education of investors and issuers on the components of good corporate governance. The fact that the scores reported by ROB, Canadian Business and Rotman improve year over year tells me that corporations have a good grasp of the “nuts and bolts” of good governance.

Since 2003, the majority of companies – and I wish I could say all – have taken steps, in varying degrees, to improve their governance regimes. For one, we have seen

considerable emphasis on board independence. Boards have appointed more independent directors, increased the independence of their committees, split the roles of chair and CEO and scheduled in-camera meetings of only the independent directors at each board meeting.

There has been an increased focus on the quality of directors. Directors understand they play an important role in the success of a company and that being a director is a demanding profession requiring a specialized set of skills. One does not become an effective director strictly by sitting in a boardroom much like lawyers do not become good lawyers by observing legal proceedings or auditors become good auditors by reading an audit file. Lawyers and accountants enrol in specialized courses to learn the intricacies of their profession and develop the specific skills needed to perform their jobs. Being a director is no different. More directors are attending director education programs to learn first hand the requirements of being an effective director.

Boards and directors are also participating in performance evaluations to help build their skills to make them more effective directors. Finally, directors are sitting on fewer boards as they recognize the demands of the job require an increased time commitment per board.

Executive compensation has become an issue of increasing concern for investors. Shareholders are speaking out - asking compensation committees to explain their rationale for the remuneration decisions they are making. There is a push for compensation programs to be directly linked with the performance of the company and for compensation committees to provide better disclosure in their annual report to

shareholders. Shareholders are also demanding more information on the post-retirement benefits granted to executives – asking companies to disclose the future liability associated with an executive’s pension plan, including any Supplemental Executive Retirement Plans or SERPs.

We have also seen an increase in regulation. The passage and implementation of the Sarbanes Oxley Legislation in the United States has impacted Canadian corporate governance. Those Canadian companies cross-listed on the US exchanges cannot escape the long-arm of SOX as they are required to comply with the provisions set out in the legislation. SOX has also influenced some of our own regulations such as those dealing with audit committees and internal controls.

Canadian regulators have been busy as well. In April of this year, the Canadian Securities Administrators published their corporate governance guidelines. In addition, over the past couple of years, regulators have developed or strengthened rules or guidelines pertaining to audit committees, continuous disclosure provisions and executive compensation disclosure, to name a few.

If good structures and regulations were all that was required for good governance then I would be tempted to claim victory and say “thank you for coming and have a nice day”.

While comfort can be taken from the increasing governance scores and from the new rules and regulations in place, we must not forget that there still exists the real possibility that governance problems will occur. To mitigate the prospect of these issues emerging, auditors and boards must remain focused on the “tone at the top” – the

attitude of top management and the board towards good governance. Also, regulators must become more focused on identifying and dealing promptly and forcefully with issues as they arise, including the assessment of appropriate penalties that discourage the undesirable behaviour from recurring.

Good governance is more than having an independent board with independent committees. It is more than holding regularly scheduled in-camera meetings of the independent directors. It is more than directors enrolling in director education programs and embracing continuous education and performance evaluation programs. It is more than regulations and laws.

Good governance is about building an effective board. It is about developing a “tone at the top” that empowers a board to truly act in the best interest of the shareholders. It is about developing “constructive tension” in the boardroom where directors ask tough questions and demand straight answers. It is about fostering a mutual respect between the board and management. It is about the board taking its stewardship role seriously.

Effective boards don’t just happen – they are the end result of a deliberate process.

The “nuts and bolts” of governance, which has contributed to the improved governance scores I discussed earlier, are an important foundation for building an effective board. However, there is more to an effective board than can be measured by a scoring system or enforced by regulations.

How is an effective board created? Fundamental is the “tone at the top” set by the board chair, the directors and the management team that understand the importance of the stewardship role the board plays in the operation of the company.

How does a chair set the proper tone? First, the chair must clearly define how the board will function. The board will understand their stewardship role and always take actions that protect the interests of shareholders. A director selection process will be implemented that assesses the needs of the board and selects directors accordingly. Directors who can fill “skills gaps”, are independent in thought and can provide meaningful contributions at the board table are important components for successful boards. In addition, potential directors who meet the selection criteria will be identified – an evergreen list. This list will be a contingency should something happen that would cause one or more directors to suddenly leave the board. Director and chair succession plans will be developed. The expectations of directors will be clear. An evaluation process will be implemented that provides an opportunity for directors to evaluate themselves, their peers and the chair. The evaluation program will also provide meaningful feedback, suggest opportunities for improvement and, in the unfortunate case, provide a means for underperforming directors to exit from the board.

Equally important in creating an effective board is a management team that understands the role the board plays in its corporate structure. As mentioned, there should be ‘constructive tension’ in the boardroom. There should be a high level of respect between the board and management. Management must be willing to enter into a meaningful dialogue with the board, to give straight answers to the tough questions

and to demonstrate flexibility in their decisions when it is warranted. Above all, management must demonstrate a high level of integrity in their dealings with the board and its committees. In presentations, management should not sugar coat the tough challenges or problems. They should present the good with the bad. And they should do this in the context of the agreed strategy for the company.

Effective boards look past compliance. They do more than meet the governance requirements set by the regulators and those scored by the ROB, Canadian Business and Rotman scoring systems. While important building blocks, these structures and processes alone certainly do not necessarily result in an effective board.

From our inception, the Canadian Coalition for Good Governance has been about building effective, high performing boards. The first document we ever published established our essential purpose: **Corporate Governance Guidelines for Building High Performance Boards**. Many of you have read this document and know its structure. This document is a collection of twelve guidelines divided into what we consider to be minimum standards and best practices. The guidelines are intended to provide a framework for establishing effective boards. It is important to distinguish that the Coalition is promoting guidelines not establishing rules.

We are not interested in setting rules. It is not our place to regulate the governance practices of companies. We are happy to leave that role to the respective provincial Securities Commissions. That being said, we will work with the commissions to ensure that regulations are enforced and that when new regulations are introduced they are fair, reasonable and do not disadvantage investors. But we are also mindful of the

constraints faced by regulators. They can only enforce minimum standards. They cannot enforce best practices.

The Coalition was formed to improve governance, not impose it. This is a very important distinction. It is our mandate to establish best practices and encourage boards to adopt and live by these.

In our analysis of a company's governance practices, we do give consideration to their governance scores. However, we use this information as a first stage in our analysis – as a way to identify potential companies we may need to contact. For each company identified, we conduct an in-depth examination of their governance practices against our guidelines.

We will not only talk with boards and directors about governance improvements, we will listen. By listening we come to understand why a company has instituted governance practices that may not meet our best practices. By listening we are able to suggest a new way that will satisfy the concerns of the board and lead to improved governance. By listening we are entering into a dialogue. Through this dialogue we engage boards in the governance improvement process. Don't forget, the Coalition is a collection of investment professionals. Individually, our business is to generate a good return on the investments we make. Collectively, we believe that good governance is an important component of successful companies. It is in our interest, the interests of our members and their clients as well as the interest of the issuers that we all work together to improve governance practices.

The Coalition promotes best practices. We applaud companies that take their governance regimes to the next level – that exceed the requirements established in the regulations. As I said, regulations are only minimum standards, as all issuers are required to follow them. The truly effective boards are those that operate at the best practice level – those companies that have implemented excellent governance practices not because they were told to do so by a regulation, but because they want to; because it is what their shareholders would expect them to do; because it makes good business sense. They believe, as we do, that there is a value in having truly effective governance.

The good thing about best practices is that they evolve. What used to be best practice a few years ago has become minimum standard today. We are fortunate in Canada to have boards and directors willing to “push the envelope” with respect to their governance practices. These boards and directors develop new governance structures and disclosures, which evolve into new best practices. And as these best practices evolve, the Coalition will be there, as the voice of the shareholder, encouraging companies to adopt these best practices through guidelines and consultation – not by rules and enforcement. That is our *raison d’être*.

In closing, I would like to acknowledge the hard work of two directors who are retiring from the board – Mr. Morgan Eastman, Chief Investment Officer of the OPSEU Pension Trust and Mr. Emilian Groch, Executive Director of the Alberta Teachers’ Retirement Fund. Both of these gentlemen have served the members of the Coalition since our inception. They have helped build an organization that started with 13 full members with an accumulated \$350 billion of assets under management to where we are today – 40

full members controlling over \$800 billion in assets. Getting to this stage wasn't easy. On behalf of the other CCGG directors and all the CCGG members, I would like to thank both Morgan and Emilian for their hard work and dedication in helping to make the Coalition the success it is today. Best wishes to you both.

Finally, I would like to welcome Mr. David Denison and Mr. Doug Pearce to the Board of Directors. Mr. Denison is the President and CEO of the CPP Investment Board. He is responsible for over \$58 billion of assets that will help the Canada Pension Plan pay the pensions of working Canadians. Mr. Pearce is the CEO and Chief Investment Officer of the British Columbia Investment Management Corporation and oversees over \$62 billion in assets managed on behalf of the retirement pensions for 350,000 British Columbians employed in various organizations within the BC public sector.

To our members and our guests, thank you for your support and your interest. We believe the Coalition is securing the interests of investors and of the individuals whose savings our members invest. Much progress has been made since our inception in 2003. We look forward to continuing this good work.

Thank you.