



**BRIEF TO SENATE COMMITTEE ON BANKING,
TRADE AND COMMERCE**
Submitted January 31, 2011

This brief is provided to the Senate Committee on Banking, Trade and Commerce by the Canadian Coalition for Good Governance (“CCGG”) to assist the Committee in its consideration of proposed Senate Bill S-206, which would establish gender parity on the board of directors of certain corporations, financial institutions and parent Crown corporations.

I. INTRODUCTION

A. The Canadian Coalition for Good Governance

CCGG is a coalition of 45 of Canada’s leading institutional investors (such as pension plans, investment managers and mutual fund managers) managing retirement assets of approximately \$1.5 trillion, an amount equal to more than half of the retirement savings of all Canadians. Attached as Appendix “A” is a list of CCGG’s members.

CCGG promotes good governance practices in Canadian public companies and the improvement of the regulatory environment to:

- Align the interests of boards and management with those of their shareholders
- Promote the efficiency and effectiveness of the Canadian capital markets

B. Good governance and the role of boards of directors

It is important for the Committee to understand why good governance is essential for Canadian companies and the Canadian capital markets. First and foremost, there is mounting evidence that good governance leads to the more efficient use of capital, better investment returns and lower levels of risk. It is important for Canadian law to enshrine good governance norms that will improve the performance of Canadian public companies and attract capital to them from Canada and internationally.

As the overseers of management and long-term corporate strategy, directors are the cornerstone of good governance. In order for them to fulfill that role, directors must be accountable to shareholders and largely independent of management. Without

accountability, there is a risk that directors' interests will become more aligned with those of management, rather than those of the shareholders.

As the providers of capital and ultimate owners of a company, shareholders delegate certain powers to boards of directors, including the powers over:

- corporate strategy;
- hiring CEOs (and often other senior executives) to design and execute strategy, monitoring their performance and establishing appropriate compensation plans;
- core corporate functions, including oversight of audit, finance and human resources;
- risk management; and
- crisis management

Because of the central role boards play in ensuring good governance, CCGG has developed detailed guidance for how to build an effective board. In March 2010, CCGG released *Building High Performance Boards*, which contains thirteen guidelines for boards, with detailed commentary accompanying each guideline. Those guidelines focus on developing high performance boards that:

- are accountable and independent
- have experienced, knowledgeable and effective directors and committees
- have clear role and responsibilities, and
- engage with shareholders.

CCGG developed these guidelines after extensive consultation and with significant input from many of Canada's leading directors and issuers, governance experts, lawyers and compensation consultants, carefully weighing the balance between financial performance and corporate governance policies. We have attached a copy of *Building High Performance Boards* for your reference.

II. IMPROVING CANADIAN CORPORATE BOARDS

A. The need for board diversity

CCGG acknowledges the need for greater gender and other forms of diversity on the boards of Canadian public companies. CCGG is aware of the research showing a correlation between the number of women on boards and improved financial performance and more effective monitoring of CEO performance. There is also evidence that diverse groups outperform homogeneous groups when performing complex tasks. In our view, increasing the number of qualified women on boards from the current low level should have a positive effect on Canadian public companies.

However, CCGG is of the view that gender diversity alone is not sufficient to ensure a high quality board. Functional diversity is the most important feature of a well-

constituted board. A high quality board will have directors with a wide variety of experiences, views and backgrounds who will bring their different perspectives to bear in their oversight of management (although some should have experience in the industry or industries in which the company operates). Boards should maintain and disclose to shareholders a “skills matrix” of director talents and board requirements to identify skill gaps on the board that can be filled by directors with different experiences and backgrounds.

B. Professionalizing the director recruitment process

One of the most important ways boards can ensure that they are sufficiently diverse is to professionalize their recruitment process. When looking for new director nominees, it has been common for boards to look to their existing social and business associates and not to go beyond their circle of relationships. By doing so, many boards have made it more likely that new nominees will have similar backgrounds, experiences, views, genders and ethnicities to those of the current directors and less likely that new directors can bring new or unique perspectives to the boardroom.

If a board institutes a professional recruitment process that looks beyond their close personal connections and searches for candidates with different experiences, views and backgrounds, bearing in mind the skills required by the board, diversity in all of its forms will likely follow.

In fact, the professionalization of the recruitment process appears to have been one of the main beneficial effects of legislation introduced in Norway that is similar to the proposed Bill. Ms. Liv Monica B. Stubholt, who appeared before the Committee in December 2010, observed that when Norwegian companies broadened their search for candidates beyond their personal connections, not only were more female candidates identified, but more qualified male candidates were as well. CCGG believes that professionalizing the recruitment process to identify more qualified male and female director candidates should be the *goal* of any public policy initiative to encourage well-constituted, diverse boards rather than just a beneficial effect.

III. THE PROPOSED BILL

A. The concept

In CCGG’s view, the proposed Bill is too blunt an instrument and will not lead to a functionally diverse board, which should be the goal of Canadian public policy. In addition, the Bill could create practical difficulties for boards. For example, consider a board that has 50% male and 50% female directors. If a woman resigns from the board, and the board finds an ideal candidate with precisely the skills and experience needed by the board at that time, but that candidate happens to be male, should the board be required to reject him simply because it would upset the gender balance of the board?

This conundrum reveals why mandatory quotas are problematic. Quotas can result in unintended consequences, not the least of which is the potential stigmatization of the female candidates they are designed to promote.

Moreover, CCGG is concerned about the disruption to corporate boards that could result from the proposed Bill, not because of the addition of women, but because of the high director turnover that would result. As there are currently so few women on boards, in many, if not most, cases the proposed Bill would require half of the directors to be replaced. Even with a three year transition period, the Bill has the potential to be very disruptive to the business of a board. During that disruption, boards could be less focused on monitoring management and overseeing long-term corporate strategy, both of which have the potential to reduce shareholder value over the long term.

In this regard, CCGG is mindful of recent research that studied the experience in Norway and concluded that the law resulted in an overall drop in firm value, with the largest drop experienced by the companies that were required to add the most women to their board¹. The authors stress that the drop was not caused by the addition of women *per se*, but rather likely due to the magnitude of the change imposed on boards over a relatively short time period. They also found that female directors appointed after the law was passed had less experience than directors appointed prior to the legislation.

There are many well-qualified Canadian women who are or could become directors of Canadian public companies. CCGG does not believe that Canadian public companies should have difficulty finding qualified female directors to serve on boards, but acknowledges that they need a sufficient amount of time to recruit qualified candidates. Professionalizing the recruitment process, as discussed above, is an important way for companies to identify qualified female candidates.

B. The structure

CCGG is also concerned with the way the gender parity provisions of the proposed Bill are structured. For example, s. 105.1 which would apply to the Canada Business Corporation (“CBCA”) states that:

- (2) the composition of the board of directors of a distributing corporation shall be such that, immediately after any election or appointment of directors,
 - (a) 50 per cent of the directors are women, if the corporation has an even number of directors; or
 - (b) the difference between the number of directors who are women and the number who are men is equal to one, if the corporation has an odd number of directors.

¹ Ahern, Kenneth R. and Dittmar, Amy K., The Changing of the Boards: The Value Effect of a Massive Exogenous Shock (May 19, 2010). Available at SSRN: <http://ssrn.com/abstract=1364470>

In CCGG's view, this structure presupposes that the directors nominated by the company will be the same ones elected by the shareholders. If shareholders' ability to elect directors is meaningful, the company cannot guarantee that the nominees put forward are in fact elected. Conceptually, the most that could be required of companies would be for them to ensure that 50% of their *nominees* are female.

It is understandable, however, for the proposed Bill to contain that supposition because in Canada, shareholders do not have a meaningful ability to nominate, elect or remove directors. As discussed in the following section, giving shareholders those rights would empower them to elect more female directors and make all directors accountable to shareholders.

IV. GIVING SHAREHOLDERS THE POWER TO AFFECT CHANGE

A. Giving shareholders the power to remove directors

Canada uses a "plurality" system for director elections, which means that directors can be elected to a corporate board without receiving a majority of votes in their favour. Currently, shareholders of Canadian public companies do not have the power to vote by proxy "for" or "against" directors. Their only right is to vote "for" them, or "withhold" their vote. A "withhold" vote has no practical effect. As a result, directors in a public company can be elected if they receive only one vote – and if they are a shareholder (which they almost inevitably are), that vote can be their own! As a result, a director can lose an election by any normal measure – receiving less than 50% of the votes in their favour or even receiving just one vote – and not have to vacate their seat on the board. To the best of our knowledge, Canada and the United States are the only countries in the world that use a plurality system for director elections.

CCGG has been working to change this law for many years. The current law allows directors to entrench themselves on boards and acts as a barrier to diversity. Until the law is changed, CCGG has developed a "majority voting" board policy which is currently being used by 130 of Canada's largest companies representing approximately 80% of the market capitalization of the S&P/TSX Composite Index. In general, the policy provides that a director who fails to win a majority of votes in their favour should resign. Ultimately, however, a board can decide not to accept that resignation. Only when majority voting is mandatory will shareholders actually be able to remove directors.

If shareholders have the power to vote against directors, they can address issues of director competence and board diversity. For example, if directors are nominated because of their social connections to existing board members and do not appear to have the necessary skills or experience to add value to the board, shareholders can vote against them. Similarly, if a shareholder suggests that a company should nominate more female directors and the company does not respond to those suggestions, a shareholder could ultimately vote against the chair or members of the nominating committee. Eventually, the company would have to appoint more diverse

directors and the remaining directors would have to become more open to building a diverse board and more responsive to shareholders' concerns.

B. Giving shareholders the power to nominate directors

Allowing shareholders to put forward a certain number of their own nominees for election to the board of directors would be an even more effective tool for building a professional and diverse board. Although there are certain avenues through which a shareholder can attempt to nominate a director in Canada, the legal requirements are onerous and prohibitively expensive, even for large institutional shareholders.

When a company distributes its information or "proxy" circular to its shareholders in advance of its annual general meeting, it includes its list of nominees for the board of directors. Significant, long term shareholders want the right to nominate a small number of their own candidates for election (for example 25%) and have their nominees listed in management's proxy circular (commonly referred to as "proxy access"). The Securities and Exchange Commission ("SEC") in the United States has published rules allowing proxy access (although they are currently being challenged) and proxy access in some form is available in many European jurisdictions.

If significant shareholders are given the ability to nominate directors, they would be empowered to nominate more women to boards and to generally ensure that the directors have sufficiently diverse experience, backgrounds and views so as to make them effective overseers of the company.

These two tools – majority voting and proxy access - would give shareholders the power to address issues of board composition in a meaningful way, and would allow shareholders to develop company specific solutions. As the providers of capital and the ultimate owners of the company, it is appropriate for shareholders to have that power. Shareholders are in the best position to affect change in a way that considers the relevant circumstances of each company and ensures its long-term, sustainable growth.

V. ENCOURAGING CHANGE

Creating a professional recruitment process and increasing board diversity does not have to be left entirely to shareholders. There are other policy initiatives, short of imposing a legislative quota, which could encourage the development of diverse, professional boards in all Canadian public companies.

For example, requiring boards to disclose their approach to board diversity, without imposing rules that stipulate how a board must be constituted, would effectively encourage more diversity. In the United States, new disclosure rules issued by the SEC now require a company to disclose whether a board nominating committee considers diversity when identifying director nominees and if it does, it must describe how. If a board has a diversity policy, it must disclose how the policy is implemented and how the board assesses its effectiveness. The SEC does not define diversity, but

notes that it may encompass different viewpoints, professional experience, education, skills, characteristics, race, gender or national origin.

In Canada, corporate governance disclosure requirements do not go that far. The Canadian Securities Administrators (“CSA”) only require companies to disclose the process by which they identify new candidates for board nomination. A recent compliance review done by the CSA notes that many companies do not even comply with that basic requirement. The only specific mention of diversity in the Canadian corporate governance disclosure requirements is in commentary from the CSA which suggests that when companies are preparing their disclosure, they should ask themselves whether they “consider diversity of experience, background and views” when they nominate a candidate for election to the board.

Strengthening the disclosure requirements for companies regarding their board recruitment process and their consideration of all forms of diversity would likely improve board practices and performance. It would also provide important information to shareholders, particularly if they are given a meaningful way to elect and remove directors. Giving shareholders the power to affect change, and giving them more information to do it effectively, is a measured and complementary strategy likely to achieve more diverse boards and improve the overall governance of Canadian public companies.

VI. CONCLUSION

CCGG agrees that the boards of Canadian public companies should be more diverse, and adding more qualified women to boards would be an important and positive development. It does not, however, support imposing legislative quotas as contemplated by the proposed Bill. CCGG is concerned that the use of a quota could stigmatize qualified female candidates. It is also concerned about the restrictions and potential disruption that could result from a strict quota, both of which have the potential to impede a board’s ability to monitor management and oversee strategy, which in turn could negatively affect the long-term sustainable growth of Canadian companies.

CCGG believes that a better approach is to reform the law so that shareholders actually have the power to elect or remove directors and to offer their own nominees for election to a board. This would allow shareholders themselves, as the ultimate owners, to ensure that each individual public company has a diverse, professional board that is composed of directors with the skills necessary to effectively oversee the company. Requiring companies to disclose their policies and practices regarding director recruitment and board diversity (or the absence of them) would complement this approach and equip shareholders with the information they need to assess a board’s performance on both issues and to take appropriate measures in response.

APPENDIX “A” CCGG MEMBERS

Acuity Investment Management Inc.
Alberta Investment Management Corporation (AIMCo)
Alberta Teachers' Retirement Fund Board
Aurion Capital Management Inc.
BlackRock Asset Management Canada Limited
BMO Harris Investment Management Inc.
British Columbia Investment Management Corporation (bcIMC)
Burgundy Asset Management Ltd.
Canada Post Corporation Registered Pension Plan
CIBC Global Asset Management
Colleges of Applied Arts and Technology Pension Plan (CAAT)
Connor, Clark & Lunn Investment Management
CPP Investment Board
Franklin Templeton Investments Corp.
Genus Capital Management
Greystone Managed Investments Inc.
Hospitals of Ontario Pension Plan (HOOPP)
Jarislowsky Fraser Limited
Leith Wheeler Investment Counsel Ltd.
Lincluden Investment Management
Mackenzie Financial Corporation
McGill University Pension Fund
McLean Budden Limited
MFC Global Investment Management
New Brunswick Investment Management Corporation (NBIMC)
NEI Investments
Ontario Municipal Employees Retirement Board (OMERS)
Ontario Pension Board
Ontario Teachers' Pension Plan (Teachers')
OPSEU Pension Trust
Public Sector Pension Investment Board (PSP Investments)
RBC Global Asset Management Inc.
Régimes de retraite de la Société de transport de Montréal
Russell Investments
Scotia Asset Management
SEAMARK Asset Management Ltd.
Sionna Investment Managers Inc.
Standard Life Investments Inc.
State Street Global Advisors, Ltd.
Teachers' Retirement Allowance Fund
TD Asset Management Inc.
UBS Global Asset Management (Canada) Co.
University of Toronto Asset Management Corporation
Workers' Compensation Board - Alberta
York University Pension Plan