

*Canadian Coalition for Good Governance  
John Thompson - June 14*

Thank you Michael ... and let add my thanks to all of you for coming today.

I'd like to start off by acknowledging and thanking the Canadian Coalition for Good Governance for continuing to raise the awareness of corporate governance issues.

Those of us who participate in the marketplace ... whether investors or businesses ... all want the same things in the end ... confidence in the markets ... and lower risk for shareholders.

So, vigilance, clarity and progress in governance benefit us all.

As Michael mentioned, I've had the opportunity and great pleasure to serve on a number of boards, internationally.

And during a recent discussion with him, he thought it might be interesting for me to share a bit of my perspective on boards in Europe and the U.S., and how Canada stacks up.

In addition, I'd like to talk about some of the board reform work yet to be done, and some of the challenges we all face in the future.

*The European experience*

Let me talk first about Europe. In contrast to the more collegial style of their North American counterparts, my experience is that European boards have a more formal approach.

The meetings tend to be quite structured ... and while all the important subjects get dealt with, the style limits the more free flowing conversations that I'm used to on this side of the Atlantic.

I think part of this is cultural and part of it is due to the two tiered board structure that exists for most European companies outside the U.K.

There is a supervisory board, elected by the shareholders, and a management board, appointed by the supervisory board. Both have legal status and responsibilities to shareholders.

The result is that many of the business discussions and a number of the key decisions have already been taken by the time they get to the supervisory board.

This doesn't diminish the oversight responsibilities of the supervisory board in any way, but it does mean that less time is spent on the "advice and counsel" roles of a board.

And the result is that more time is spent on the approval and regulatory aspects of a board's duties rather than on strategy and future direction.

Having said that, I do find that the Europeans are very advanced when it comes to accepting and implementing best practices in governance.

Their focus may be explained by the fact that the UK was one of the first to call for greater regulation and guidance, some twelve years ago with the Cadbury report. The US didn't have Sarbanes-Oxley until two years ago, so you could say Europe had a 10 year head start.

For example, Europeans have been leaders in adopting the separation of the CEO from the Chair, who is usually an independent director.

Their regulations have long required that supervisory boards be independent ... even to the point ... and this is one of the cultural differences I mentioned ... that independent directors do not hold significant amounts of shares ... because total independence is deemed more important than shareholder alignment.

On audit, I would say that the Europeans are less regulated than in North America ... probably because their accounting system relies more on basic principles than on highly detailed rules.

The international companies, though, are all adopting Sarbanes-Oxley ... and are in the same stages of implementation as we are.

On compensation, the Europeans have also been on the forefront of reform, having tied variable pay and equity awards very closely to performance, for some time now.

However at this point in time, I would say that in several countries, they are over-regulated.

For instance, there is now legislation in a number of jurisdictions that prescribes maximum bonuses and equity awards at a low multiplier of salary ...

And, this is now putting less pay at risk and homogenizing compensation ... taking away from the very "pay for performance" principle they started with.

Finally, I'd mention that Europe favours term limits for directors ... usually in the neighborhood of ten years ... to ensure board renewal.

The downside of course, is that in complex organizations, it takes a while for directors to really understand the business ... and the best performers are often those that are just getting ready to retire from the board.

Perhaps the preference for term limits goes hand-in-hand with the fact that I've yet to run across a strong peer evaluation system on European Boards.

### *The American perspective*

Moving on to the US – I've found the boards there tend to be quite a bit less formal than in Europe, probably because of the more informal American culture, and the fact that the US boards are generally smaller in size.

I find the discussions more freewheeling, and more participative ... often with frequent interruptions and direct questioning.

And I also think that the US boards I've been associated with spend more time discussing results, competition, customers and business strategy, rather than spending a lot of time on regulations, and process.

I don't mean to suggest regulations are ignored ... and there is a clear increase in the amount of attention paid to them these days ... but in my experience, the overall content of the meetings continues to be weighted towards business results and actions, and new investments.

I believe part of the reason is the continuing focus in the US on short term earnings and meeting analysts' quarterly estimates. There's a much stronger preoccupation than in Europe.

And another reason might be that the boards I've been on have been mostly made up of active CEOs, with healthy egos, who are highly experienced, have a good grasp of strategy, and a sophisticated understanding of the issues.

This CEO makeup may also explain why U.S companies have not been as quick to split CEO and Chair roles.

There has historically been a strong resistance to splitting the roles, even in the face of shareholder pressure, as recently seen at Disney

I will say, however, that over the last twelve months, I have seen some of America's most admired CEOs change their position on this, and I think the tide is beginning to turn.

In the area of audit, there is clearly a major change ... both from the audit committees' side as well as the auditors themselves.

The time spent by audit committees has probably more than doubled with the new quarterly results and MD&A review requirements ... in camera sessions ... and adherence to the numerous new accounting and business control regulations.

And while the question of compensation has long been on other countries' radar screens, it is only now becoming elevated in the U.S.

There has been some positive reform ... more stock options are being expensed ... the days of the super grants seem to be over ... and we're seeing some option plans move to long range, performance-based, restricted stock plans.

However, the relative levels of executive compensation in the USA still remain high ... many of the proxy statements are falling short of detailed disclosure ... and there is still some strong opposition to expensing options ... mainly from those companies with huge option plans where expensing options would risk wiping out a significant portion of their earnings.

### *Canadian boards*

Now a few words about Canadian boards.

Overall, from a governance perspective, I would say that Canadian boards are in pretty good shape ... with Canadian financial institutions and widely held energy companies, in particular, being very good role models.

And this is reinforced by what you've just heard from David, as well as in the comments of some of our leading thinkers in the area, like Claude Lamoureux of Teachers.

The Canadian Board style tends to be much closer to the US style than the European. It is more informal and collaborative ... and it's generally accepted among major corporations, that boards are there to provide experienced advice and counsel ... informed debate on strategy ... and insightful input on succession.

I don't see Canadian boards being overly focused on regulations, as in Europe, or quite as free wheeling as in the US, but on an appropriate blend of both.

In terms of reform, Canadians have been early adopters of many governance best practices including the splitting of CEO and Chairman roles ... disclosure and transparency ... and appointing strong majorities of independent directors.

And I would say that when I compare our progress on my Canadian boards with that of my American boards, we are at least as far along, if not further, in implementing best practices in audit, compensation, and nomination & governance

This is no accident. Long before Sarbanes-Oxley, Canada was highly influenced by the UK's Cadbury report in 1992, followed by the TSX's Dey Report guidelines.

That led to other early reports including the "Five Years to the Dey Report" and the Saucier report. So, good governance has been on our radars for a while.

And because many of our companies do business internationally and have stocks listed in the US, we have been working over the past two years to be compliant with Sarbanes Oxley and US Exchange guidelines, as well as the newly published Canadian Securities regulations.

### *The work that remains to done*

Now, while we've seen major improvements in governance over the last few years here, it doesn't mean that there isn't a lot more to do.

So what are some of these remaining issues?

First, we will continue to have some unique challenges in the area of independence because, in Canada, a larger proportion of our major companies ... approximately 25% of our top 200 ... are closely controlled. Organizations like Powercorp, Brascan, Irving, Sobey, and Magna.

This brings about some director and overall board independence issues ... as well as issues around subordinated voting structures ... and these will need continuing work.

Second, compensation, including pensions, of all named corporate officers and board members is still a hot topic. And I believe shareholders will continue to call for enhanced disclosure as well as continuing tighter links to performance.

Then, I think there is more work to be done around peer evaluation of directors. A lot of good work has been done on overall board evaluations, but not as much yet, on individual directors' contributions.

And I think this needs to be done on a constructive basis. That means continuously developing a director's skills and performance rather than just having simple pass/fail tests.

Term limits is another area of ongoing debate. Europe has embraced the idea, while in the US, most leading companies prefer other methods of achieving board renewal.

In Canada, where our qualified directors represent a smaller pool, term limits present a unique challenge. And boards will need to look at all the options including making better use of peer evaluations.

Another area that is still a challenge is the requirement for a board and management to certify an organization's business control position and the effectiveness of its business processes.

Those of us working with Section 404 of the Sarbanes-Oxley Act have already had a taste of dealing with these complexities ... in fact the US regulators have now had to extend the deadline for compliance another year ... until mid 2005 ... because of the huge workload involved.

### *Some challenges ahead*

Well, boards will continue to face many issues, and governance best practices will remain a moving target.

But some of the challenges will also need to be dealt with by the regulators. Nobody should argue against the benefits of governance rules and regulations. But there are considerations.

One of the important things is for our regulators to make sure that our Canadian rules are harmonized, both nationally and internationally.

At a high level, I think this is being accomplished ... regulators around the world are all dealing with similar issues and addressing them in similar ways when it comes to basic principles.

But we also need to be diligent on the details. And, it's particularly important in Canada that we harmonize our regulations with the US.

For example, right now there are different definitions of what an independent director is, depending on which country you're in, and which set of guidelines you look at.

Canada's rules surrounding independence of audit committee members ... and proposals from several provinces on director independence ... suggest that if you have a relative who works for the auditing firm of a company ... you will not be considered independent even if that relative is not part of the auditor's audit or assurance practices.

In addition, it appears that a director would not be considered independent if they have a relative employed by the company ... and that relative is earning more than \$75,000 per year, even if that relative is a non-executive. In the U.S., the cap is \$100,000 US, and the relative needs to be an executive ... so you can see the differences.

The Canadian rules appear to extend somewhat further than their US counterparts.... and the differences can be confusing and onerous ... especially in a country like ours ... where the pool of qualified directors is more limited ... and non-material overlaps are likely to exist in our smaller communities.

A second thing we need to be watchful of, is that we don't become over-regulated, and believe that rules and check lists by themselves will lead to good governance.

Enron is a case in point. Their board complied with many of the criteria for good governance, but totally missed the boat on what was going on.

My point is that board members need to carve out enough time from the regulatory work to ensure they are spending quality time on the fundamentals of a business ... performance, strategy, accounting, succession plans ... and time to give management wise counsel.

As an example, I found that as Chairman of TD Bank, we were starting to be forced to cut back on our quality time in board meetings in order to deal with all the procedural matters. Too much of our time was being pre-programmed.

The way we dealt with it, was first by creating one additional board committee and then spending more time in all the committees dealing in depth with all the regulatory details.

We were then able to reserve the first third of our regular board meetings ... up to two hours ... for an open, free format discussion between the board and the CEO ... with no other management present. This allowed frank and open dialogue on all the challenges, opportunities, strategic updates and human resources.

We then devoted the next third to oversight activities with all of the senior management ... review of the financials ... business unit presentations, board approvals etc.

The final third is then spent on detailed reports from the committee chairs ... as well as special review topics like succession or strategy with selected management present ... and then finally, an in-camera session for board members only.

This approach allowed us to rebalance our time for the new environment. We are spending a lot more hours in total, when you add in the committee time, but we've regained control of the value-added portions of our board meetings.

### *Conclusion*

Well, in closing ... as I look at practices around the world ... I believe that Canadian corporate governance is on solid footing. Good governance is a moving target and we will always have lots more to do.

Organizations like the Canadian Coalition for Good Governance (CCGG) are making a difference and helping us all, directors, shareholders, employees and regulators ... as we work to create more confidence in the markets ... and lower risk for shareholders. Thank you.