CLARKSON
Centre for Board Effectiveness

2012 marks the eleventh edition of the BSCI, and we continue to see improvement among S&P/TSX Composite Index firms.

The CCBE recognizes the generous support of the Canadian Coalition for Good Governance and Ontario Teachers' Pension Plan toward our annual publication of the BSCI.

Board Shareholder Confidence Index Methodology

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About the Clarkson Center

The Clarkson Centre for Business Ethics and Board Effectiveness (CCBE) is the locus of corporate governance research and communications at the Rotman School of Management. Our mandate is to monitor Canadian corporate governance trends and to provide guidance to firms looking to improve their board effectiveness and disclosure.

About the Board Shareholder Confidence Index

Ongoing since 2003, the Board Shareholder Confidence Index (BSCI) is an annual examination of governance practices among Canadian Boards of Directors. While many variables can contribute to Board effectiveness, including those best observed from inside the boardroom, we examine factors which shareholders look for when determining a Board's ability to fulfill their duties. These criteria differ from the TSX Guidelines for effective corporate governance in their emphasis on the shareholder's perception of risk.

The BSCI evaluates and rates Boards of Directors on their potential to act effectively and by their performance as indicated through past practices. The score is developed using criteria separated into three sections, and the result is a transparent, objective, and adaptable rating system which assigns companies listed on the S&P/TSX Composite Index an overall score ranging from AAA+ (highest) to C (lowest). Our scoring criteria are divided into three sections: **Individual Potential**, which focuses on the directors themselves; **Group Potential**, which examines the board as a whole; and **Past Practices**, which analyses on a variety of board outputs.

INDIVIDUAL POTENTIAL

The potential of individual directors to contribute a fully-independent point of view is an important element of effective governance. This section gauges how effectively individual directors are positioned to represent shareholders' interests. The criteria used in this analysis fall into three principle categories: **Director Independence**; **Director Stock Ownership**; and **Director Meeting Attendance**.

DIRECTOR INDEPENDENCE

Director Independence measures the degree to which a director's decisions may be influenced by factors outside of shareholders' interests. In particular, the criteria in this section examine the potential influence of management, other directors, and other boards.

INDEPENDENCE FROM MANAGEMENT

In order for shareholders' interests to be fully represented by the Board of Directors, individual Directors must be able to act independently from the interests of management, as relationships with management increase the potential risk that a Director will put executive interests before those of the shareholder.

A director is considered related to management if he/she meets any of the following criteria:

- the Director is employed by the Company being scored or by a company which is a subsidiary, parent, or sister company to the Company being scored (currently or within the last three years);
- the Director is an executive of any affiliated company;
- the Director has, personally or through the Director's firm, provided legal, auditing, or consulting services to the Company (within the last 3 years);
- the Director is kin to the CEO;
- Any other relationship deemed material by the CCBE which does not fall under one of the above categories.

At least two-thirds of the Board must be independent from management or else a deduction is made. The deduction increases as the proportion of related Directors increases.

SCORING

% Independent of Management	Deduction
<30%	-15
30% - 49.9%	-10
50% - 59.9%	-5
60% - 66.6%	-3
66.7% or more	No deduction

DIRECTOR INTERLOCKS

It is also important that relationships between Directors be kept to a minimum. If two Directors sit on more than one Board together, this is referred to as a "Director Interlock." A Director Interlock results in a perceived risk of decisions being made in the interest of another company. If, however, the CEO of the Company being scored has an interlock with a fellow Director who is the CEO of the interlocking board (i.e., both directors are CEOs and sit on each other's company's Board), this is referred to as an "Executive Interlock."

A deduction is made if more than one Director Interlock is present on a Board.[1] Further additional deductions are made for every Executive Interlock present on the Board.

SCORING

# of Interlocks	Deduction
>1 Director interlock (or 1 three-Director interlock)	**-5**
1 or more Executive interlocks	**-2 per Executive interlock**
1 or 0 Interlocks (or 0 three-Director interlocks) and 0 Executive interlocks	**No Deduction**

1 Previously, scoring in this section had only recognized interlocks between those companies listed on the S&P/TSX Composite Index. Since 2007, however, the scope has been broadened to consider the Boards of all other publicly traded companies upon which Directors serve.

EXCESSIVE BOARD MEMBERSHIPS

In order to perform effectively, a Director must be able dedicate as much of his or her time to the board as is necessary. As a result, a perceived risk emerges when a director appears to have too many obligations beyond her/his duties on the Board being scored. One of the most frequent ways in which this perceived risk manifests itself is when a director has an excessive number of other public company directorships outside that of the Company being scored.

A deduction is made for every Director who is a member of more than five S&P/TSX Composite Index boards including that of the Company being scored.

SCORING

# S&P/ TSX Boards	Deduction
>= 5 Boards	-5 (per Director)
Otherwise	No Deduction

OVERALL INDEPENDENCE LETTER GRADES

Total Deductions	Grade
No Deduction	AAA
-2 to -4	AA
-5 to -7	A
-8 to -9	B
More than -10	C

DIRECTOR ATTENDANCE

Poor director attendance may suggest that a director is overcommitted and unable to dedicate sufficient time to Board matters, or that a director is no longer making his/her role on the Board a priority, thus resulting in a perceived risk.

A deduction is made if a director failed to attend at least ¾ of board or individual committee meetings and no reasonable explanation for these absences is provided. If, however, a director with poor attendance is not standing for re-election, no deduction will be made as it is assumed that the Board has dealt with the problem. A deduction will be automatically made if there is not enough disclosure to determine director attendance.

SCORING

Meeting Attendance	Deduction
All directors attended at least 75% of all meetings	**No Deduction**
At least 1 director attended < 75% of meetings but is not being re-elected	**No Deduction**
At least 1 director attended <75% of meetings and is standing for re-election	**-2 per director (max deduction of -10)**
Not enough disclosure to determine if a director missed excessive meetings	**-10**

OVERALL DIRECTOR ATTENDANCE LETTER GRADES

Total Deduction	Grade
No Deduction	**AAA**
-2	**AA**
-4	**A**
-6	**B**
Less than or equal to -8	**C**

DIRECTOR STOCK OWNERSHIP

A Director, however independent and experienced, requires motivation to act in the best interest of shareholders. Although motivation is difficult to quantify, stock ownership is generally accepted as an effective and demonstrable means of inciting motivation. As such, director motivation is measured by comparing Directors' stock ownership to their annual retainers.

The value of a Director's annual retainer is calculated as the sum of: (**1**) the stated annual cash retainer; (**2**) the grant date value of any share-based awards; and (**3**) the disclosed fair value of option grants. Fees paid for Committee membership, attendance and chair retainers are excluded.

When Directors receive an annual retainer, a deduction is made when the stock ownership multiple is less than ***three*** times the calculated annual retainer. Where no retainer is paid to Directors, a deduction occurs when a Director's stock ownership is ***less than or equal to*** $30,000.

WHEN A RETAINER IS AWARDED:

Ownership Multiple	Deduction
1 director owns less than 3x retainer	-3 per director (max deduction of 15)
Otherwise	No deduction

WHEN NO RETAINER IS AWARDED:

Average Share Ownership	Deduction
1 director owns less than $30,000	-3 per director (max deduction of 15)
Otherwise	No deduction

OVERALL STOCK OWNERSHIP LETTER GRADES

Total Deductions	Grade
No deduction	AAA
-3	AA
-6	A
-9	B
Less or equal to -12	C

GROUP POTENTIAL

In order for Directors to effectively represent shareholder interests, the Board must ensure that its structures and processes allow for clear and open discourse, and for the clear assessment and improvement of the board's collective skillset. The factors used to determine Group Potential are: **Board Structure**; the implementation of a **Board Evaluation Processes**; the use of a **Board Skills Matrix** to manage board composition; and **Disclosure of Continuing Education Opportunities and an Orientation Process** for directors.

BOARD STRUCTURE

A Company's score in this category is based on the characteristics of its Board and meeting structure. The structure of a Board and its meetings can enhance or impede the Individual Potential of its Directors, as well as affect the Board's output. Structural measurements include:

i) The separation of CEO and Chair positions;
ii) Independence of Audit, Compensation and Nominating Committee members;
iii) The ratio of voting rights to share ownership between share classes.

CEO/CHAIR SPLIT

The perceived potential for the Board to operate independently from management is decreased if the CEO and Chair positions are not separated. This potential is also decreased if the Chair is separate from the CEO but still related to management.

A deduction is made if there is no CEO/Chair split. A smaller deduction is given to companies which have not split the CEO/Chair position but which have appointed an Independent Lead Director to lead Board meetings. A smaller deduction is also given when the Chair is not the CEO but is nevertheless considered related to management through other means.

SCORING

Split?	Deduction
No split/no Lead Director	**-15**
Split / Chair is Related	**-10**
No Split / Lead Director Appointed	**-5**
Split / Related Chair / Lead Director Appointed	**-5**
Otherwise	**No Deduction**

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COMMITTEE INDEPENDENCE

Full independence of a company's committees is necessary to ensure that executive compensation, company accounting, and board nominations are handled without conflicts of interest between management and shareholders.

Deductions are made if a Director who is considered related to management is a member of the Audit or Compensation committees. In the case of the Nominating committee, some input from management can be of value without creating significant conflicts, and as such a deduction will be made only if two or more Related Directors sit on the committee. Directors who are related to management through their role as executives of a Parent company will not trigger a deduction if they sit on the Nomination or Compensation committees. This is due to the fact that Parents are, in effect, shareholders.

In the case of the Audit and Compensation Committees, additional relationships may render a director related to management exclusively within the context of these committees. If a director is either a non-management major shareholder (i.e., the director holds >30% of outstanding votes) or has a family relationship with a non-management major shareholder, she/he will be considered related with respect to his/her membership on the Audit and/or Compensation committee, but not related with respect to the criteria outlined above under the Individual Potential section.

If an interlock exists between two executives on the Compensation Committees of each other's companies, the involved Directors are considered related with respect to these Compensation Committees. This is to discourage situations where executives from different companies are determining each other's salaries.

Each committee is scored separately.

SCORING

Committee Independence	Deduction
Related Director(s) on Audit Committee or 1 director with an Executive interlock	**-10**
Related Director(s) on Compensation Committee or 1 director with an Executive interlock	**-10**
2 or more Related Directors on the Nominating Committee	**-10**
Full Committee Independence	**No Deduction**

SHARE STRUCTURE

Many companies have more than one class of share (e.g., Class A, Class B, etc.), and in some cases the different classes do not have equal voting rights.

EXAMPLE:

Class	Votes per Share	Shares Outstanding
Class A Voting	1	10,000
Class B Non-Voting	0	5,000,000

In this case, the entirety of the company's voting rights are associated with a small minority of the outstanding shares. An imbalance of voting rights such as this decreases shareholder influence on Board decisions, which in turn decreases the incentive for Directors to represent the interests of shareholders.

Deductions in this area are graduated. As the disproportion between shares and voting rights increases, so too does the deduction.

SCORING

Share Structure	Deduction
<20% of Equity Controls >80% of Votes	-20
<40% or Less Equity Controls >60% or Votes	-15
<50% of Equity controls >50% of Votes	-10
>50% of Equity controls >50% of Votes	No Deduction
No Dual Class or Subordinated Share Structure	No Deduction

OVERALL STRUCTURE LETTER GRADES

Total Deduction	Letter Grade
No Deduction	AAA
-5	AA
-10 to -19	A
-20	B
-25 or greater	C

SYSTEMS

EVALUATION PROCESSES

Formal and regular evaluation processes allow directors to assess and improve the performance of the board while identifying possible trouble spots. The BSCI monitors both Individual Director Evaluations, in which directors use self-assessments or peer reviews to determine their own competencies and areas for improvement, and Full-Board Evaluations, in which the directors evaluate their performance as a cohesive unit. When undertaken effectively and regularly, these separate but related systems provide Shareholders with an assurance of the Board's commitment to ongoing improvement.

In order to receive a perfect score in this category, a company must implement and disclose regular and formal evaluation processes for the Board as a whole and for each of its individual Directors. Scoring is based on disclosure of the evaluation processes; if the general presence of an evaluation system is mentioned, but without details as to processes, a deduction is still made. Full-board and individual director evaluations are scored separately.

SCORING

Evaluation Processes	Deduction
No Full-Board Evaluation	-10
No Individual Director Evaluation	-10
Otherwise	No Deduction

SKILLS MATRIX

The annual Management Information Circular is the primary resource for educating shareholders regarding the directors standing for election. As such, the inclusion of a skills matrix in the Circular helps illustrate to shareholders how the abilities of the board as a whole meet the needs of the organization while also highlighting the specific skills that individual director bring to the boardroom. Use of a skills matrix also provides a framework through which Boards and Shareholders can identify gaps and redundancies in board composition.

Ideally, a skills matrix will disclose two sets of information: first, the skills individual directors standing for nomination possess; and second, the skills the board has determined it requires and how many directors possess these skills. That said, disclosure of the skills of the board as a whole are more valuable than the disclosure of individual skills, as this information provides Shareholders with the most concise understanding of the Board's strengths and weaknesses.

If the skills of the board as a whole are disclosed, but the skills of individual directors are not, a small deduction is made. If the inverse is true, a larger deduction is made. If no skills matrices are present, a full deduction is made.

SCORING

Skills Matrix	Deduction
Disclosure of board skills but no director skills	**-1**
Disclosure of director skills but no board skills	**-2**
No disclosure of board or director skills	**-3**
Full Disclosure of director and board skills	**No Deduction**

DIRECTOR CONTINUING EDUCATION & ORIENTATION

By providing formal continuing education opportunities to directors, boards can ensure that their directors have effective skills and knowledge in areas relevant to the board's role. Such opportunities may include training manuals, site visits, courses and retreats, or other creative and unique approaches, as long as the program is formal and regular. When disclosing their continuing education programs, however, boards can foster further shareholder confidence by disclosing the specific educational activities conducted in the past year, thereby enabling shareholders to gain a better understanding of which competencies the board is attempting to emphasize and improve. For full disclosure credit, the board can also disclose which directors attended these activities.

Director orientation is another important educational component, ensuring that new directors effectively overcome any learning curves and acquaint themselves with the core knowledge required of their role. As with ongoing continuing education programs, the exact form of the orientation is for the board to decide, but in order to inspire shareholder confidence the program must be formal and repeatable.

In order to receive full marks, companies must disclose a formal continuing education process, the specific educational activities conducted in the most recent year, the attendees for each activity, and a formal orientation process.

SCORING

Director Education & Orientation	Deduction
Does not disclose this year's continuing education	-2
Does not disclose formal process for Director Orientation	-1
Does not disclose Continuing Education Process	-1
Full disclosure of continuing education including this year's activities and director orientation process	No Deduction

OVERALL SYSTEMS LETTER GRADES

Total Deduction	Grade
No Deduction	AAA
-1 to -2	AA
-3 to -9	A
-10 to -19	B
Less than or equal to -20	C

BOARD DECISION OUTPUT (PAST PRACTICES)

Directors are required to make numerous decisions which directly affect shareholder confidence in the Company and in the Board. While these decisions cover a broad swath of ground, they can be grouped into three principle categories: **Compensation**, which includes decisions that influence dilution, "pay for performance" policies, and company loans; decisions which affect **Director Elections**; and finally, decisions regarding **CEO Succession Planning**.

COMPENSATION

Dilution

The granting of options dilutes returns that would otherwise go to shareholders. A small amount of dilution is often unavoidable, but a deduction is made if options issued and outstanding represent more than 5% of a company's outstanding shares, and a larger deduction is made if dilution exceeds 10% of outstanding shares.

SCORING

Dilution	Deduction
Company Options >10%	**-10**
Company Options >5%	**-5**
Company Options <5%	**No Deduction**

OPTION RE-PRICING

When a company's share performance has suffered, the cost of exercising stock options can be greater than the cost of purchasing stock at market value. In such a case, a company may decide to lower the exercise price in order to align it with the market value of the stock. Option re-pricing is perceived, however, as relieving Directors and executives of their responsibility for the company's performance.

A deduction is made if a company has re-priced their options within the last three years.

SCORING

Dilution	Deduction
Options Re-priced Within 3 Years	**-20**
Otherwise	**No deduction**

CEO PAY IS RELATED TO PERFORMANCE

It is the responsibility of the Board of Directors to determine CEO compensation. In order to best represent the interests of a company's shareholders, such compensation should be associated with the company's performance. A deduction is made here if there is no explicit link between the company's financial performance and the determination of the CEO's bonus.

SCORING

Bonus Disclosure	Deduction
No financial performance connected to CEO bonus	**-15**
Otherwise	**No deduction**

OPTION GAINS DISCLOSED

While boards are now required to disclose a grant date fair-value for options awarded to executives during the most recent fiscal year, the requirement to disclose the value of option gains for the year has been removed. Disclosure of option gains provides shareholders with a clearer impression of CEO compensation outcomes over time. A deduction is made if option gains are not disclosed.

SCORING

Option Gains Disclosed	Deduction
No disclosure of option gains	**-5**
Option gains disclosed	**No deduction**

OPTIONS TO DIRECTORS

The granting of options to directors is becoming less common. However, many companies continue this dilutive practice. A deduction will be made if directors are eligible to receive options and/or have received them within the past 3 years.

SCORING

Options to Directors	Deduction
Directors receive options	**-5**
Directors are not eligible for options or have not received them in the past 3 years	**No deduction**

EVERGREEN OPTION PLAN

Generally, shareholders must approve the replenishment of a company's option plan once a specific number of options have been issued. That said, many companies are now introducing Evergreen Option Plans, through which the maximum number of options approved for issue stands as a percentage of outstanding shares rather than a specific number. These plans allow companies to continue granting options in any amount up to a certain percentage dilution. Evergreen plans limit shareholder input into option plans, while increasing the possibility of higher dilution.

A deduction will be made if the Company has an Evergreen Option Plan in place.

SCORING

Evergreen Option Plan	Deduction
Company has Evergreen Option Plan	**-5**
Otherwise	**No deduction**

OUTSTANDING LOANS TO DIRECTORS OR EXECUTIVES

Although most companies have discontinued granting loans to their Directors and executives, many still have outstanding loans on their books, and some others do still grant loans. We regard loans to employees or directors as an inappropriate use of company money in most cases.

Companies with outstanding loans to directors or executives will receive a deduction. If the loans are interest-free, the deduction will be larger. Companies which are financial institutions, however, and which grant loans to executives and Directors at consumer rates receive no deduction for this, as these companies are in the business of granting loans and it is not in the company's best interest for these individuals to obtain loans from competitors.

SCORING

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

OVERALL COMPENSATION LETTER GRADES

Total Deduction	Grade
No Deduction	AAA
-5	AA
-10 to -19	A
-20 to -29	B
Less than or equal to -30	C

DIRECTOR ELECTIONS

MAJORITY VOTING

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

A deduction is made if a firm does not have a majority voting policy.

SCORING

Majority Voting	Deduction
Majority Voting policy in place	No deduction
No Majority Voting	-10

INDIVIDUAL VOTING

Most large public boards have replaced slate voting (i.e. a single resolution wherein the shareholders are unable to vote for individual directors) with individual director voting, allowing shareholders to cast or withhold their vote on a name-by-name basis. This increases shareholder say on board composition, increasing confidence in those elected.

A deduction is made if the Board uses a slate voting system.

SCORING

Individual Voting	Deduction
Shareholders vote for individual directors	No deduction
Slate voting	-10

ANNUAL ELECTIONS

Most boards hold annual elections requiring every director to stand for re-election every year, but a few exceptions remain. A deduction will be made if at least one director is not elected annually.

SCORING

Annual Elections	Deduction
All directors are elected annually	No deduction
At least 1 director is not elected annually	-10

DETAILED VOTING RESULTS

Many boards provide shareholders with a detailed report of voting results for all resolutions listed in the Form of Proxy. This ensures transparency and communication with shareholders. A deduction will be made if there is not sufficient disclosure on all voting resolutions, indicating the percentage/number of votes for/against/withheld.

SCORING

Detailed Voting Results	Deduction
Detailed voting results for director elections and all other voting matters on form of proxy	No deduction
Not enough disclosure for all voting results	-5

OVERALL DIRECTOR ELECTIONS LETTER GRADES

Total Deduction	Grade
No Deduction	AAA
-5	AA
-10 to -19	A
-20	B
Less than or equal to -25	C

CEO SUCCESSION

SUCCESSION PLAN DISCLOSURE

One of the Board's most important responsibilities is ensuring that a proper succession plan is in place in the event of the voluntary or involuntary departure of the CEO. Without a formal and reliable succession plan for the CEO, the company is exposed to significant risk, possibly accompanied by the often-significant cost of hiring externally. Disclosure of a formal succession plan for the CEO in the Information Circular reassures shareholders that these risks are being considered.

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

SCORING

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

OVERALL CEO SUCCESSION LETTER GRADES

Total Deduction	Grade
No Deduction	AAA
-1	B

TOTAL SCORES

Each company begins with 100 points from which Individual Potential, Group Potential, and Past Practices deductions are made. Total letter grades are determined as follows:

Overall Score	Grade
100	AAA+
95-99	AAA
88-94	AA
75-89	A
50-74	B
< 50	C