

Board Shareholder Confidence Index

Our research in corporate governance focuses on Boards of Directors, social networks, and corporate performance. The reports produced by the Clarkson Centre for Business Ethics & Board Effectiveness CC(BE)² are timely, reliable, actionable, and comprehensive.

Developed in spring 2003, the Board Shareholder Confidence Index is comprised of the factors often used by active shareholders to assess Boards of Directors. While there are other variables not in our model that contribute to the effectiveness of Boards -- including elements that can only be observed from inside the boardroom -- we capture factors affecting shareholders' confidence in the Boards' abilities to fulfill their duties. These factors are different from the TSX Guidelines for effective corporate governance in that they take into account the shareholders' perception of risk. Based on factors available to those outside the walls of the boardroom, we evaluate and rank Boards of Directors by their potential to act in an effective way and by their performance, as indicated by past practices. The score is developed using four linked steps. The result is a transparent, objective, and adaptable rating system that assigns companies listed on the S&P/TSX Composite Index a [score](#) from AAA+ [highest] to C [lowest]. [Click here for Current Scores](#)

GLOSSARY OF TERMS

1. Individual Potential

Individual Potential = [1\(a\) DIRECTOR INDEPENDENCE](#) + [1\(b\) STOCK OWNERSHIP](#)

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, and independently from the other Directors. Stock ownership indicates that a director is aligned to other shareholders and motivated to improve the company's performance. Individual Potential is comprised of these two factors: [Director Independence](#), and [Director Stock Ownership](#).

2. Group Potential

Group Potential = [2\(a\) MEETING STRUCTURE](#) + [2\(b\) EVALUATIONS](#)

Group Potential represents the potential for the Board as a whole to best represent the interests of shareholders, without compromising the Individual Potential of the Directors. The factors determining Group Potential are [Board Meeting Structure](#), and the implementation of [Board Evaluation Processes](#).

3. Past Practices

SEE [3\(a\) BOARD DECISION OUTPUT](#) FOR MORE DETAILS

The past practices of a Board are assessed by evaluating the results of their decisions. Scoring is based on practices that investor surveys generally regard as being opposed to the best interests of shareholders, including:

- Excessive option grants, and/or dilution
- Option re-pricing
- CEO compensation significantly UP while share price significantly DOWN

1(a) Director Independence

i. Independence

Director Independence measures the independence of individual Directors from each other, as well as from company Management.

Relationships with Management increase the potential risk that the Director will act in the interests of executives before those of the shareholder. If any of the following apply to a Director she/he is considered related to management:

- Employee of the company (currently or within three years).
- Executive of any affiliated company
- Director or Director's firm provides legal, auditing, or consulting services to the company (within the last 3 years).
- Kinship to CEO or Chair (if Chair holds >10% of company's shares).

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

% Independence	Deduction
Less than 30%	-15
30% - 50%	-10
50% - 60%	-5
60% - 66.7%	-3
Over 66.7%	No deduction.

ii. Interlocks

It is also important that relationships between Directors be kept under control. If the same two directors sit on more than one Board together, there is a perceived risk that decisions are being made in the interests of another company; this is called a Director Interlock. A deduction is made if there is more than one Director Interlock present on a Board.

Scoring

# Interlocks	Deduction
>1 Interlock	-5
1 or 0 Interlocks	No Deduction

iii. Excessive Board Memberships

In order to perform effectively, a Director must not have too many obligations beyond her/his duties on the Board. A Company receives a deduction for every Director that is a member of more than five S&P/TSX Boards.

Scoring

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

Overall Independence Letter Grades

Total Deductions	Grade
No Deduction	AAA
-3	AA
-5	A
-8	B
More than -10	C

1(b) Stock Ownership

A Director, however independent and experienced, needs to be motivated to act in the best interest of the shareholders. Motivation is measured as a function of a Director's stock ownership in the company.

Our calculation is based on the average value of stock owned by the third of the Board with the fewest shares, compared to the value of the Directors' annual retainer. Directors with less than three years' tenure on the Board are not included in this calculation.

$$\text{STOCK OWNERSHIP MULTIPLE} = \frac{\$(\text{AVERAGE SHARE OWNERSHIP OF BOTTOM THIRD OF DIRECTORS})}{\$(\text{ANNUAL RETAINER})}$$

A deduction is made if the multiple is less than four; the graduated deduction increases as the multiple decreases.

Overall Ownership Scoring and Letter Grades

Ownership Multiple	Deduction	Grade
4 or more	No deduction	AAA
3-4	-3	AA
2-3	-5	A
1-2	-10	B
<1	-15	C

2(a) Structure

A company's score in this category is based on the characteristics of its Board meeting structure. The structure of a Board and its meetings can either encourage or impede the [Individual Potential](#) of its Directors, as well as affecting the Board's output. Structural measurements include:

- 1) The separation of CEO and Chair positions
- 2) Independence of Audit and Compensation Committee members
- 3) The ratio of voting rights to share ownership between share classes.

i. CEO/Chair Split

If the CEO and Chair positions are not separated, the perceived potential for the Board to operate independently from the influence of Management is decreased. A deduction is made if the positions are not fully separated. A smaller deduction is given to companies with no CEO/Chair split who have appointed an Independent Lead Director to lead Board meetings; or to companies that have split the CEO and Chair positions, but the Chair is related.

Scoring

Split?	Deduction
No CEO/Chair Split	-10
Split / Chair is Related	-7
No Split / Lead Director Appointed	-5
Split / Related Chair / Lead Director Appointed	-5
Otherwise	No Deduction

ii. Committee Independence

Full-independence of a company’s committees is necessary in order to ensure that executive compensation and company accounting are handled without conflict of interest between Management and shareholders.

In order to avoid deductions here, every member of the Audit and Compensation Committees must be fully independent. This means that if any director considered dependent in the Director Independence section sits on either of these committees, the company receives a deduction.

NOTE: EXECUTIVES OF THE PARENT COMPANY ARE CONSIDERED UNRELATED ON THE COMPENSATION COMMITTEE.

If a Compensation Committee interlock exists between executives of two or more companies, the involved directors are considered related with respect to all interlocked Compensation Committees. This is to avoid situations where executives from different companies are determining each other’s salaries.

There are additional restrictions placed on committee membership: deductions are also made if any Related-Independent Directors sit on the Audit or Compensation Committees. The criteria for Related-Independence include:

- Member of the board of any affiliated company.
- Non-Management major shareholder (>30% votes) of company of interest.
- Kinship to non-management major shareholder of company of interest.

If related directors sit on both the Audit and Compensation Committees, separate deductions are made for each committee.

Scoring

Committee Independence	Deduction
Related Director(s) on Audit Committee	-10
Related Director(s) on Compensation Committee	-10
Full Committee Independence	No Deduction

iii. Share Structure

Many companies have several classes of shares, and often the different classes are not allowed equal voting rights. An imbalance of voting rights often means that influence toward Board decisions is taken away from most shareholders.

EXAMPLE:

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

In this case, all of the company’s voting rights associated with a small minority of the outstanding shares. Often, these shares are held by company executives, thus not allowing any voting power to the majority of shareholders.

Deductions in this area are graduated; as the disproportion between shares and voting rights increases, so does the deduction made. No deduction is made for companies with multiple share classes if every class is allowed the same number of votes per share.

Scoring

Share Structure	Deduction
• <20% of Equity Controls >80% of Votes	-30
• 40% or Less Equity Controls 60% or More Votes	-20
• <50% of Equity controls >50% of Votes	-15
• >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	A
-20	B
-25 or greater	C

2(b) Systems (Evaluations)

In order to receive a perfect score in this category, a company must implement regular and formal evaluation processes for both the Board as a whole, and each of its individual Directors. Scoring is based on disclosure of details regarding the evaluation processes. In other words, if evaluations are mentioned, but no details are given, a deduction is still made. Separate scoring is done for full-Board evaluations and individual Director evaluations.

Scoring

Systems	Deduction
No Full-Board evaluation	-10
No Individual Director Evaluation	-5
Otherwise	No Deduction

Overall Systems Letter Grades

Total Deduction	Grade
No Deduction	AAA
-5	AA
-10	A
-15	B

3(a) Board Decision Output (Past Practices)

i. Dilution

Dilution occurs when options granted to executives and directors make up a significant proportion of the outstanding shares, thus diluting returns that would otherwise go to shareholders. A deduction is made if options comprise greater than 10% of a company's outstanding shares. A deduction is also made if options granted to the CEO comprise greater than 5% of a company's outstanding shares. Both of the above are thresholds set by the TSX.

Scoring

Dilution	Deduction
CEO Options >5%	-5
Company Options >10%	-10
Otherwise	No Deduction

ii. Option Repricing

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 repricing is perceived as relieving Directors of their responsibility for the company's performance. A deduction is made if a company has repriced their options within the last three years.

Scoring

Dilution	Deduction
Options Repriced Within 3 Years	-20
Otherwise	No deduction

iii. CEO Compensation Increases while Share Price Decreases

Determination of CEO compensation is a responsibility of the Board of Directors. In order to best represent the interests of the company's shareholders, the compensation of the CEO should be associated with the company's performance. A deduction is made here if a CEO's total compensation increases by more than 25% following a year during which the company's share price decreased by more than 25%.

Scoring

CEO Compensation	Deduction
CEO Compensation Increases by 25% While Share Price Decreases by 25%	-15
Otherwise	No deduction

Overall Output Letter Grades

Total Deduction	Grade
No Deduction	AAA
-5	AA
-10	A
-20	B
-30	C

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	AAA
90	AA
75	A
50	B
<50	C