CFGR-CCBE 2011 Director Survey Summary

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Introduction

In early 2011, the Canadian Foundation for Governance Research (CFGR) commissioned the Clarkson Centre for Board Effectiveness (CCBE) to undertake a study of challenges currently facing Canadian corporate directors. The goal of this endeavour was to identify current governance issues that would most benefit from future study.

Methodology

In February and March 2011, CCBE delivered an online confidential survey to members of the Institute of Corporate Directors to gather measurable feedback on key governance topics. The purpose of the survey was threefold:

1. Quantitatively identify the most important challenges currently being faced by Canadian directors in the boardroom.
2. Determine if directors are aware of the tools and information resources available to them
3. Assess whether or not directors feel that these tools and information resources are sufficient to help them overcome these difficult challenges

CCBE based the content of this survey primarily on interviews conducted with 44 Canadian directors who represented diverse industries and sectors. The feedback we received from these directors resulted in the identification of seven broad topics. For the purpose of our survey, we broke these down further into 13 areas of immediate concern to Canadian directors:

Director Recruitment
- Board composition
- Director diversity

Board Independence
- Board effectiveness and evaluations
- Boardroom decision-making
- Board-management relationships
- Director Compensation

Succession Planning

Executive Compensation

Director Education

Risk Management
- Board oversight of risk
- Board oversight of change of control

Director Liability

Shareholder Engagement

These formed the focal points of our director survey, which was completed by 304 Canadian directors in February and March, 2011.

The following report outlines the results of the survey, illustrating where directors feel that Canadian boards are strong, where they believe they can improve and whether or not there are sufficient resources available to assist them. Accompanying this document are two other reports: a broad scan of existing governance research and tools (*CFGR-CCBE 2011 Governance Literature Review*) and an analysis of where CCBE believes CFGR should target its future research initiatives (*2011 CCBE Research Recommendations*). A full description of the methodology of our study can be found below in *Appendix I: Study Methodology*.

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1. About Our Survey Sample

Number of Participants: 304

Sector Breakdown

Participants were asked to indicate whether they have experience on boards in six defined sectors: Large public, small public, large private, small private, not-for-profit and government. Each defined sector was represented by at least forty individual respondents. Throughout the survey, participants were asked to provide 'generalized' feedback based on the sum of their experience as directors, rather than focusing specifically on one board or sector.

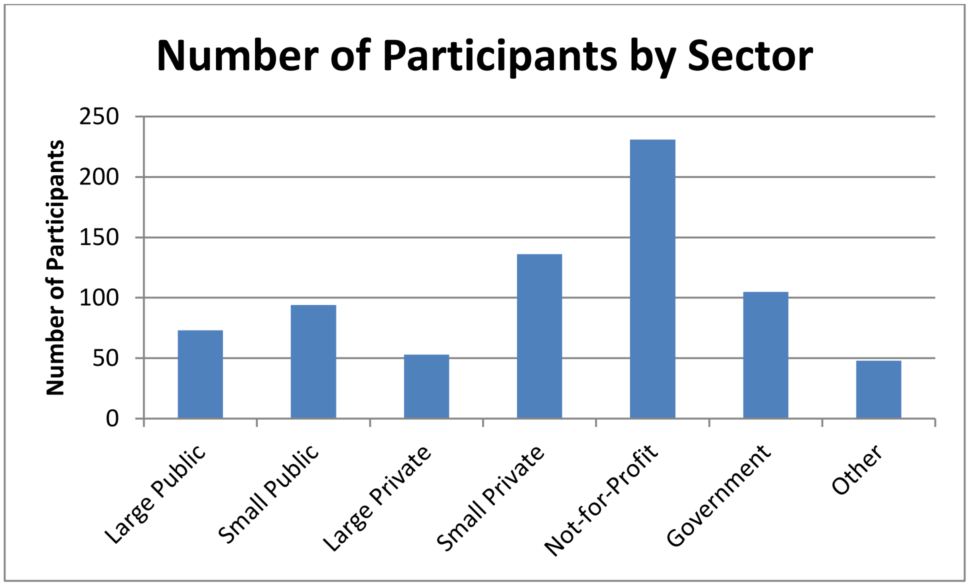

Figure 1 – Sector Breakdown

Gender

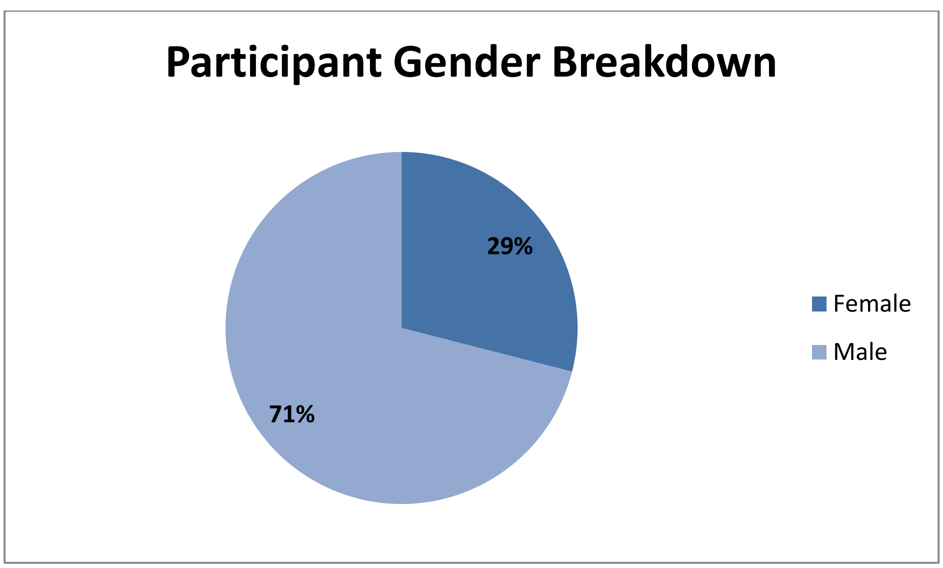

Figure 2 – Gender Breakdown

Province

Approximately 80% of our survey participants reside in Ontario, Alberta or British Columbia. The remaining 20% comprises directors from seven other provinces and one territory.

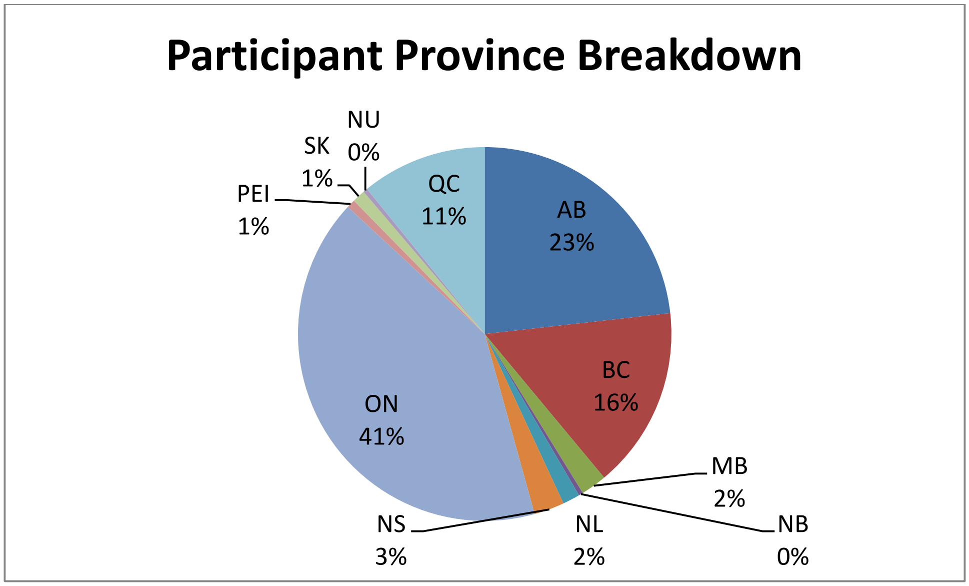

Figure 3 – Province Breakdown

Board Experience

Almost half of our survey participants have more than 10 years of director experience. The average participant has been on at least one board for 14 years. Median board experience is 11 years.

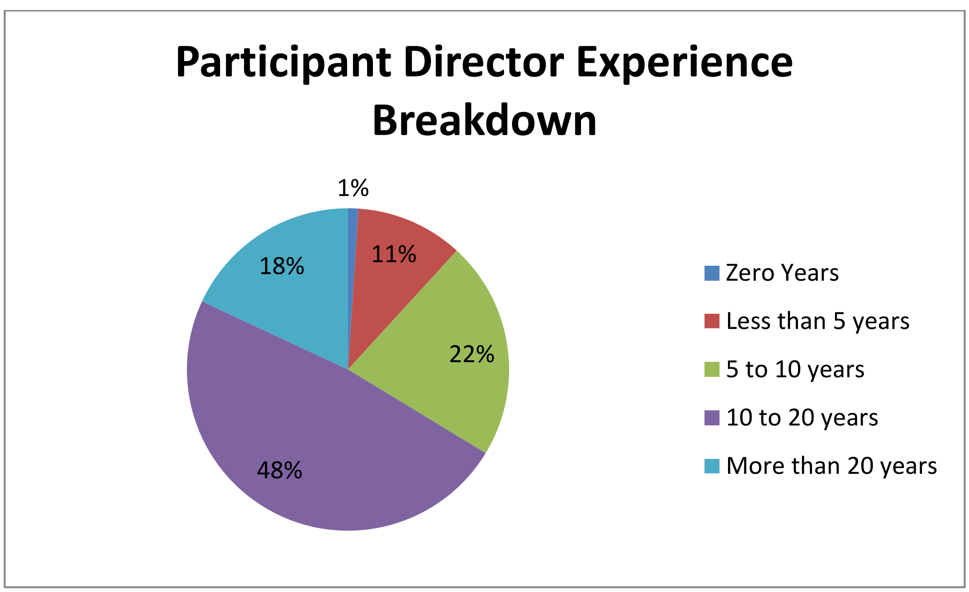

Figure 4 – Director Experience Breakdown

Number of Boards

Nearly half of our survey participants currently sit on two or three different boards. There is a notable positive correlation (0.50) between the number of boards and the diversity of sectors in which the participant has board experience. This indicates that a participant is more likely to currently sit on multiple boards if they have board experience in multiple sectors. Currently, the average survey participant sits on 3 boards, with a median of 2.

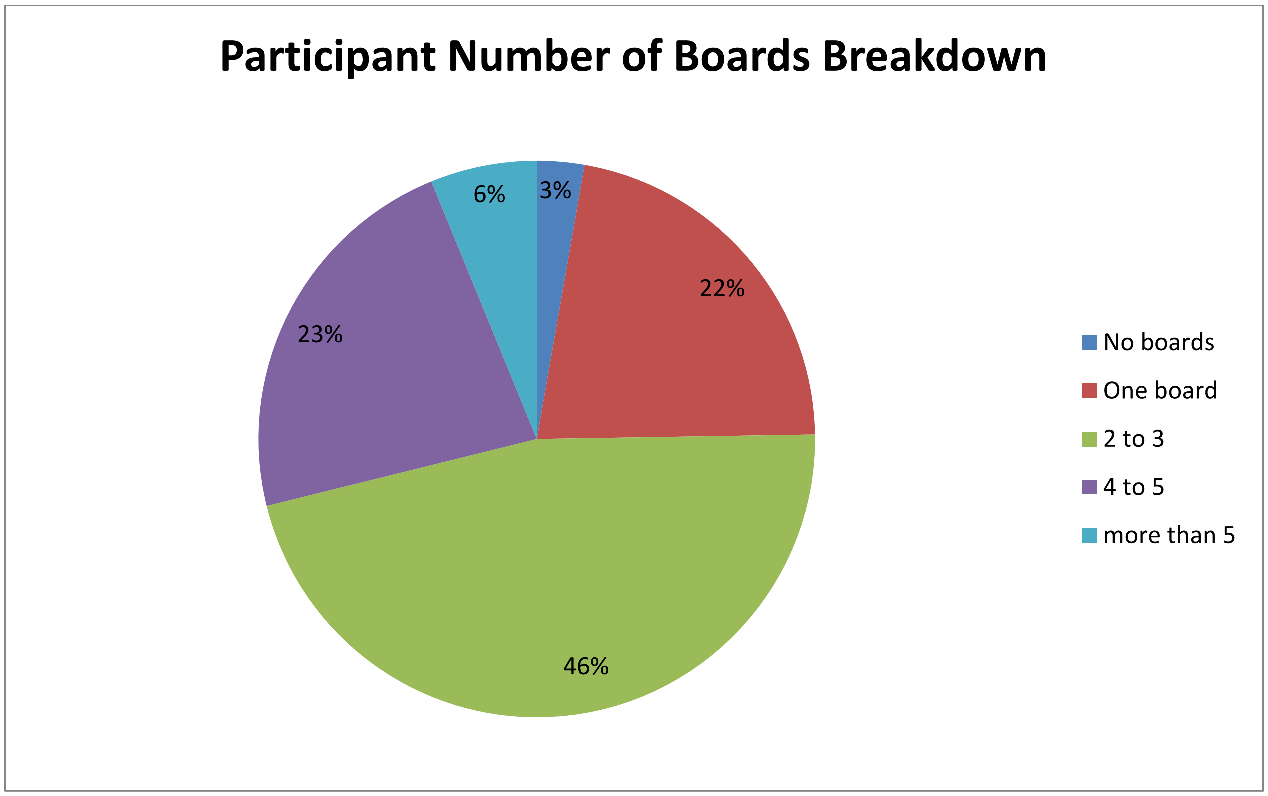

Figure 5 – Number of Boards

Chair Experience

59% of our participants have experience as a board chair.

Director Education

73% of our participants have completed at least one continuing education program as a director.

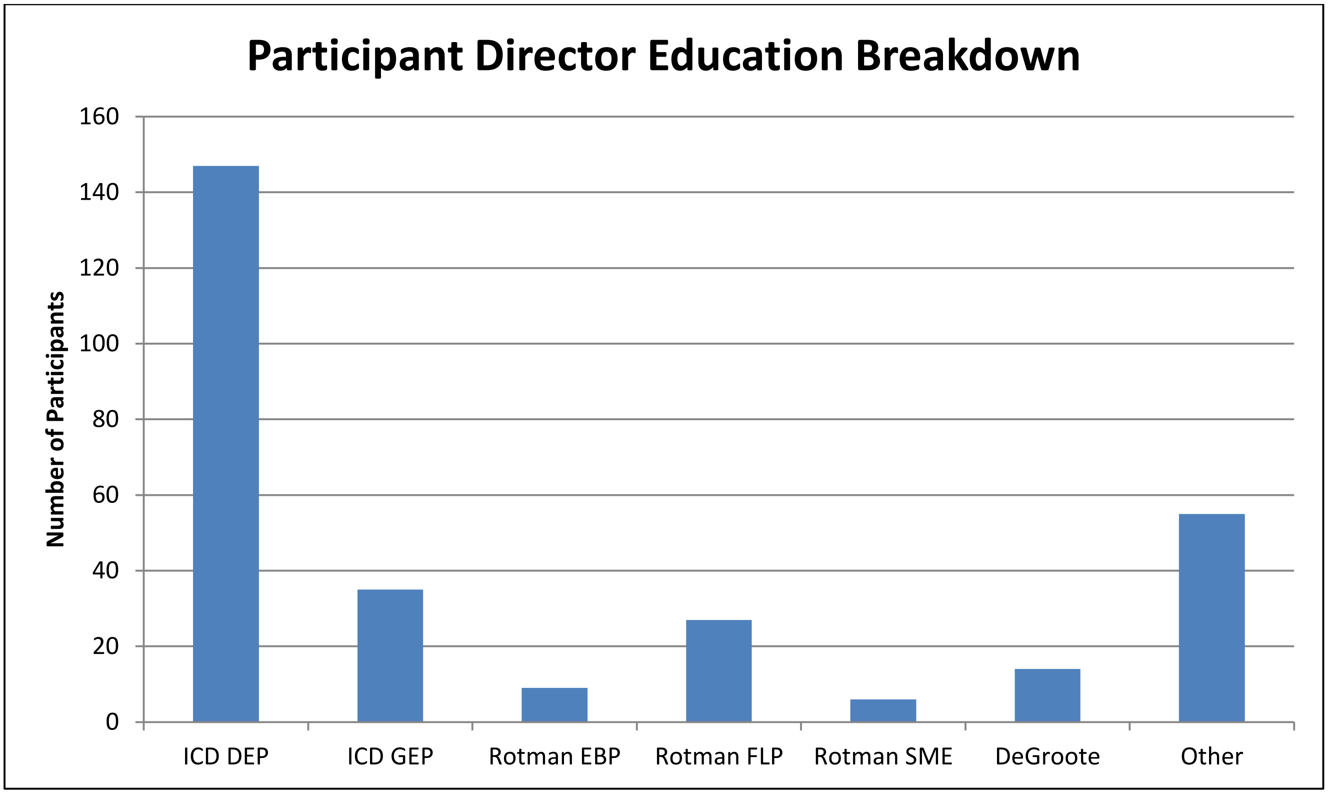

Figure 6 – Director Education

2. Board Composition

Our discussions with Canadian directors showed near unanimity in the view that proper board composition is crucial to the success of any board. Achieving an appropriate diversity of backgrounds, skills, personalities and points of view is seen as the only way for boards to optimize their decision-making and their oversight effectiveness.

Director Nomination Processes

Participants were asked to select from a list each of the processes/resources that their boards use to identify new board members. Nearly all boards have a formal board committee that is responsible for director nomination, and also rely on recommendations from existing board members. 72% of boards track the balance of skills on their board using a skills matrix – indicating that these boards consider board composition on an ongoing basis.

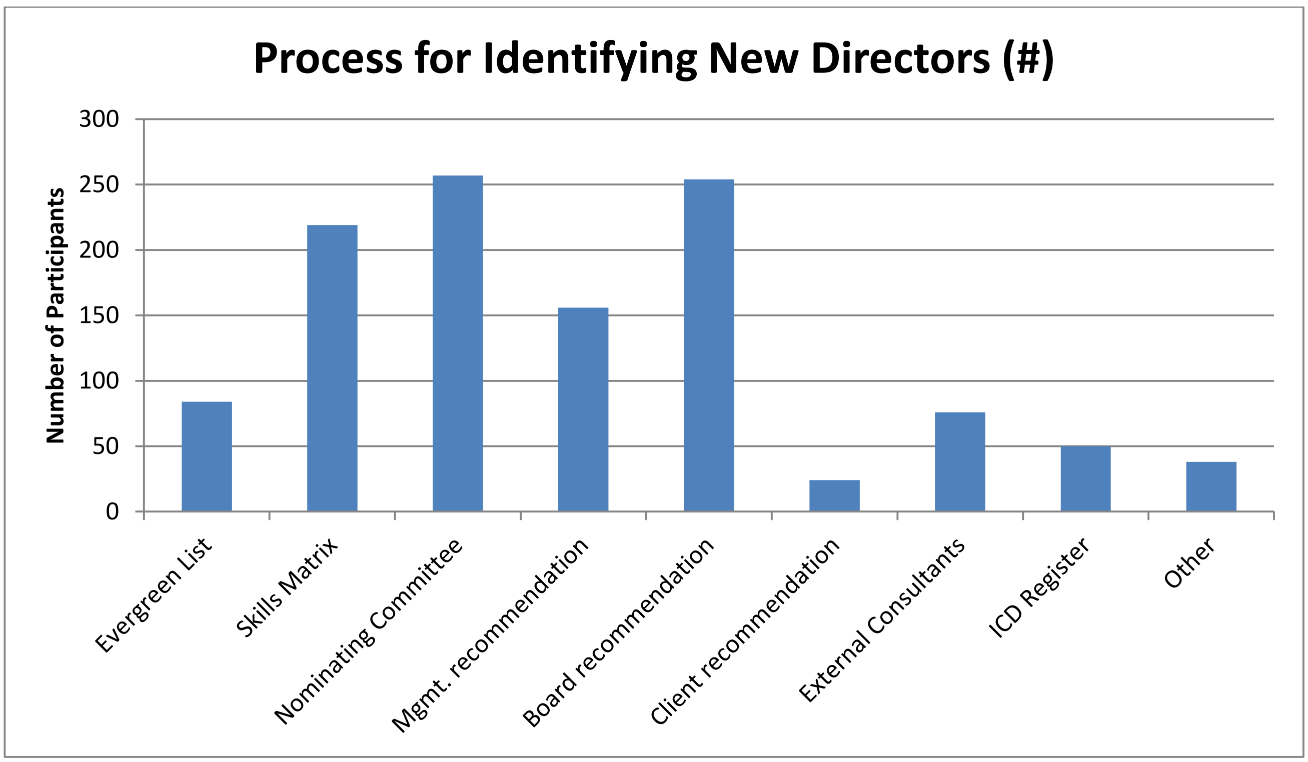

Figure 7 – Nominating Processes

There is very little variation in nomination processes between sectors. The only significant variance was observed in the hiring of external consultants. Large public boards are much more likely to retain outside advice than other sectors (see Figure 8 below).

Other processes identified by participants include:

- Government appointments (where applicable)

- Recommendations from member/community base (where applicable)
- Advertisements
- DeGroote Register Board Watch
- CICA Directors Source
- Recommendations from business/community partners
- Solicitation of directors from shareholders/stakeholders
- Search for directors in more advanced or larger peer organizations

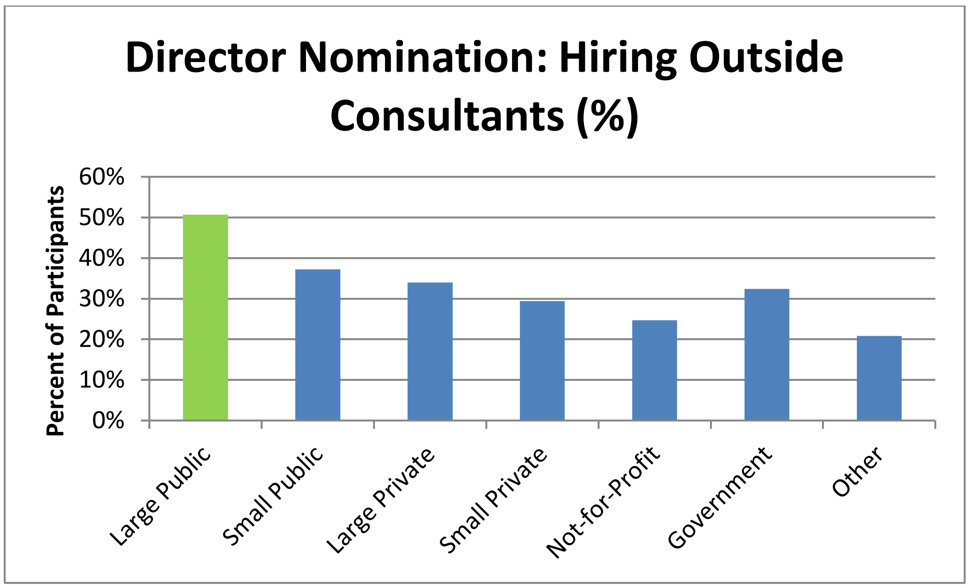

Figure 8 – Director Nomination Consultants by sector

Board Composition Successes

In addition to skills profile and prior experience, a large majority of participants indicated that their boards consider personality to be a high priority when identifying new directors. This indicates that cultural fit and skill balance are both key factors. The success of this approach is evident: 85% of participants agreed that their boards undertake fair and rational decision-making processes. Moreover, most directors feel they have sufficient access to useful resources to guide them both in managing board renewal and optimizing board composition.

Generally, survey participants are satisfied with the outcomes of their nomination processes and the overall balance of skills on their boards. 72% of respondents agreed or strongly agreed with the statement "*I am confident that my boards have the right balance of skills in order to be effective,*" with only 11% disagreeing or strongly disagreeing.

Board Composition Challenges

Despite these successes, Canadian boards are currently struggling to overcome several key challenges in managing board composition. Firstly, fewer than half of respondents feel confident in their ongoing planning for director succession; rather, their boards wait for vacancies to appear before actively identifying suitable candidates. This trend is consistent across all sectors and indicates a potential risk if the sudden departure of one or more board members results in a gap in key skills or expertise.

Secondly, only 39% of participants felt confident that their boards would take action to dismiss under-performing board members. Although this trend was consistent across all sectors, it is slightly more of a concern among not-for-profit and government boards. In order to better understand why boards are unlikely to remove under-performing directors, it would be beneficial to research why boards are unlikely to remove them as well as the connection between board renewal trends and the board electoral system.

Among the written comments provided by our participants, gender diversity was a high priority in terms of board composition optimization. Many respondents indicated that they have personally experienced the positive impact of an increased focus on appointing more women to their boards, and feel that the trend toward gender diversity is not moving as quickly as it should. Similar comments were made in terms of ethnic diversity and the overall "reflection of Canada's demographic." Directors would benefit from further research examining the effect of increased gender and ethnic diversity on boards

Several participants also cited 'political' board appointments as a serious obstacle. Although government boards face the most obvious challenge here, as directors are often appointed by government shareholders, this challenge is also evident in cases where board appointments are made through personal relationships with existing board members or managers. Politically-motivated board appointments can result in an environment where boards struggle to take action to deal with under-performing directors, as political tensions may interfere. In speaking to this point, one participant stated that "Chairs without courage are the biggest obstacle to a successful board."

<u>Gaps In Available Resources – Board Composition</u>

Although a majority of participants feel that they have access to helpful resources to overcome challenges in director nomination and board skills optimization, we received some written suggestions as to what types of additional resources would be valuable to Canadian boards:

- Hands-on courses, simulations to illustrate effective processes:
    - Applying a skills matrix to your board
    - Selecting the right directors
- More sophisticated matching services to help boards identify the best available candidates for their needs
- Mentorship for inexperienced directors from seasoned board members
- Affordable or free access to sophisticated tools and training for not-for-profit boards
- Checklist of characteristics established and endorsed by the ICD.

3. Gender and Ethnic Diversity on Boards

When our interview participants discussed director ‘diversity’, they understood it to include not just diversity of gender and ethnicity, but also diversity of opinion. For Canadian directors, ‘ideal’ diversity among board members ultimately depends on the type of organization and its goals, but also on the ‘personality’ of the board and its members. As a result, directors emphasize the importance of finding the person with the right fit, typically expressed in terms of the right personality and personal attributes. Such characteristics cannot typically be gleaned from a candidate’s CV. The process required in order to maximize the effectiveness of director recruitment under these conditions is highly nuanced and time-consuming. Many directors are concerned that their boards may not be equipped with the proper tools to ensure the ongoing effectiveness of this process.

Our survey asked participants if their boards were currently actively seeking female or ethnic minority directors. Half of the participants surveyed indicated that their boards consider gender and ethnic diversity to be a high priority concern. There was very little variance between sectors on this point. However, only 43% of boards are currently actively pursuing female board members, and only 21% are seeking ethnic minorities.

While both male and female participants showed low confidence that their boards are actively recruiting female directors, men (47%) were slightly more confident than women (38%). The gap is much smaller, however, when looking at the statement “My boards consider director diversity to be a high priority concern.” Here, only 19% of female participants and 21% of male agreed or strongly agreed.

In the comments section for this segment of the survey, opinions about the value of pursuing gender and ethnic diversity were very polarized. Many participants suggested that diversity for its own sake presents the risk of recruiting directors with insufficient skills or experience – as a result, these participants suggest that seeking the most appropriate director regardless of demographics is the most effective approach. Conversely, many other participants feel that increasing director diversity and optimizing director skills need not be mutually exclusive. Rather, these participants feel that increased focus on gender and ethnic diversity on boards is a crucial driver of effective decision-making.

<u>Gaps in Available Resources – Director Diversity</u>

A majority of participants (63%) agreed or strongly agreed that sufficient resources are available to boards to help optimize director diversity. However, many boards continue to struggle to reach the balance they would like. Several gaps in available resources were suggested:

- Targeted programming and courses on identifying candidates to increase diversity
- Tools to develop skills matrices that focus beyond management experience
- Directory or database of female and ethnic minority directors
- Targeted networking events for female and ethnic minority candidates to meet CEOs and Chairs
- Research providing evidence that increased diversity enhances decision-making and/or performance
- Targeted training for people within the desired diversity group

4. Board Effectiveness and Evaluations

There are numerous different cultural and procedural factors that can have a significant impact on the effectiveness of the board, whether it be a single director who is required to carry a majority of the workload, an overbearing CEO or internal politics between the board members. The responsibility of the board, regardless of the dynamics of the boardroom, is to be effective in overseeing the strategic health of the firm.

In this section of the survey, we asked participants about the effectiveness of the processes their boards have in place to ensure ongoing board and director effectiveness, as well as the outcomes of these processes.

<u>Board Evaluations</u>

Only four participants in our sample indicated that they do not undertake a board evaluation process. A significant majority of participants (68%) agreed or strongly agreed that their boards follow up effectively on issues that are raised through the board evaluation process. In addition, there is high confidence that resources exist to help boards overcome challenges in the evaluation process if needed.

<u>Board and Director Effectiveness</u>

Our survey asked participants for feedback on the effectiveness of their boards' processes in two areas:

1. Ensuring that board members stay abreast of the organization's business realities
2. Ensuring clarity regarding the board's role and its separation from management

Participants demonstrated very high confidence in these areas with more than 75% of responses agreeing or strongly agreeing that their board is effective on these two points. In fact, sixty respondents indicated that their boards are able to achieve very strong role clarity without implementing formal processes to do so. Finally, 291 out of 304 participants (96%) indicated that they agree or strongly agree with the statement "*I am able to make a valuable contribution to my boards,*" while 285 participants (94%) said the same about their fellow directors.

We asked participants to identify the single factor that most impedes a director's ability to make a valuable contribution in the boardroom. By far the most commonly selected response was "*Too busy with outside matters,*" indicating that – more than expertise, personality, or conflict of interest – directors who do not have sufficient time to commit to a board present the greatest difficulty (see Figure 9 below). Among participants who chose "other" in response to this question, the most common responses were as follows:

- Lack of courage to voice opinions, or lack of courage on the part of Chairperson to solicit opinions
- Under-preparation for board meetings (e.g. has not read board materials)
- Insufficient understanding of the organization's culture

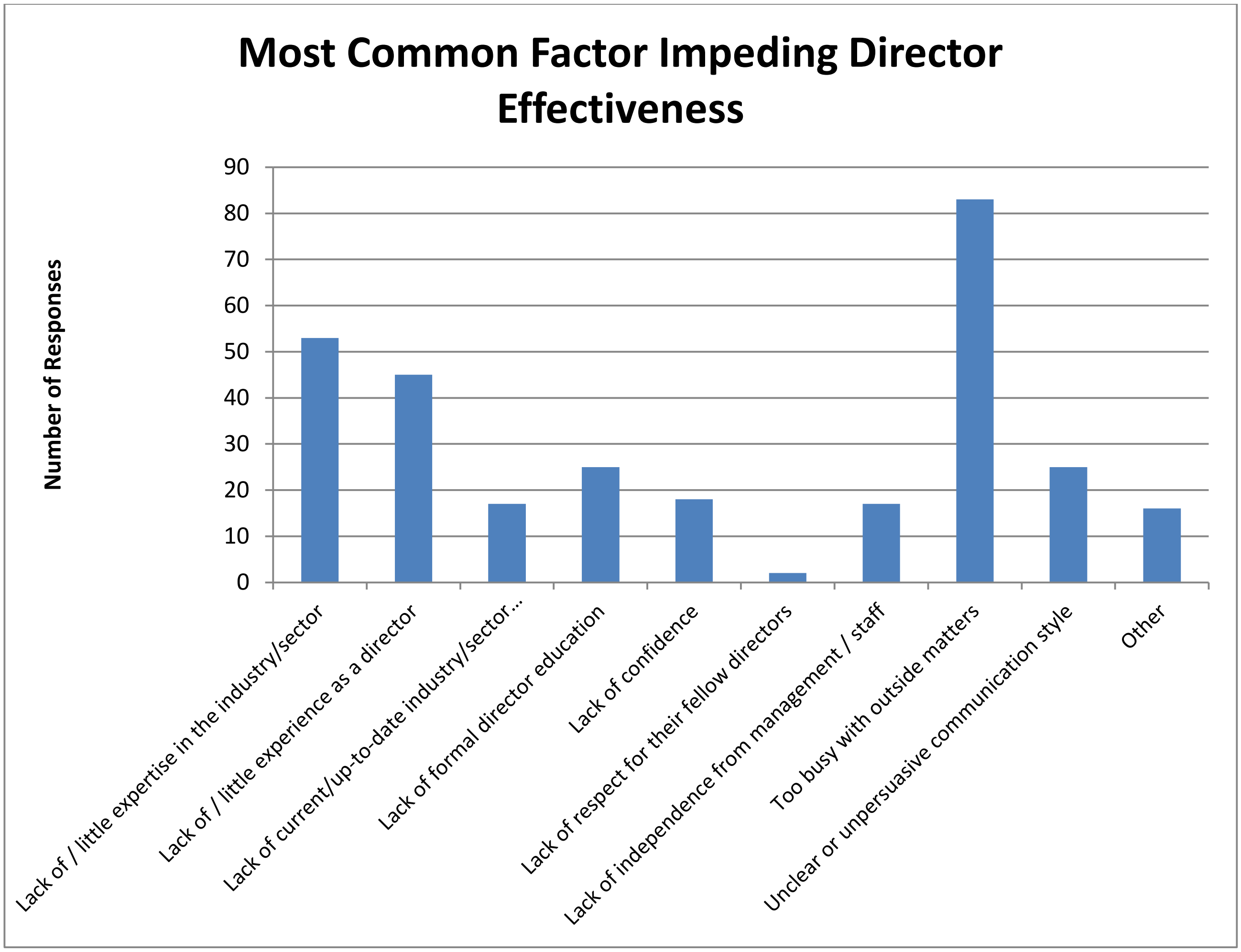

Figure 9 – Factors impeding director effectiveness

<u>Gaps in Available Resources – Board Effectiveness / Evaluation</u>

Generally, our feedback from participants regarding the availability of useful resources in this area suggests that tools and other resources do in fact exist, but that boards often do not use them. Our responses suggest that can be a result of boards not being aware that tools are available, or that the resources are too expensive to be accessed by many organizations. Several participants suggested that a lack of resources is not the missing piece, but rather that a shift in culture may be necessary in order for boards to be less accepting of underperformance by directors.

5. Board-Management Relationship

During the interview process, many of the directors identified the Board-Management relationship as an important aspect of the director's role. There were many interviewees who pointed out that the dynamics and boundaries of the relationship are different for every board and are frequently determined by the stage of development of the organization. Moreover, when things go badly, it becomes a significant risk.

Survey participants indicated extremely high confidence in their boards' ability to maintain productive, value-added relationships with senior management. 94% of respondents agreed or strongly agreed with the statement "*My boards are able to maintain productive relationships with management.*" Some participants commented that separation of the Chair and CEO roles is essential.

Gaps in Available Resources – Board-Management Relationship

Although participants believe that their boards are currently maintaining effective relationships with management, several commented that the risks associated with breakdowns in this area are very high, and that access to certain types of resources would be of great assistance. Suggestions included:

- Access to and participation in board simulations and case studies focusing on board-management breakdown
- Targeted education for *potential* board members
- Education for directors on providing fair and constructive feedback.

6. Top Management Succession Planning

According to our interviews, Canadian directors believe that top management succession planning is a critical and persistent challenge. Succession planning is seen as one of the most important roles of the board, and perhaps the most direct way for Boards to impact the future of the organization. In the current economic environment, shareholders and other stakeholders have increased their focus on and scrutiny of organizational risk and, accordingly, succession planning. Our interview participants indicated that their boards are rarely, if ever, fully prepared for the departure of their top management in the normal course of events, and that they often struggle to access information to help them overcome this challenge.

Our survey asked participants for feedback regarding their implementation of formal succession planning processes for top management, and the effectiveness of these processes. Just over half of respondents (53%) are confident that their succession planning process will result in proper staffing at all times, while the rest feel under-prepared for the departure of key staff. When asked to indicate which factor most commonly impedes the effectiveness of succession planning, most of our participants (62%) indicated either that the board does not devote enough time, or that succession planning is not an immediate concern – both of which signify a lack of ongoing engagement in the process on the part of the board (See Figure 10 below).

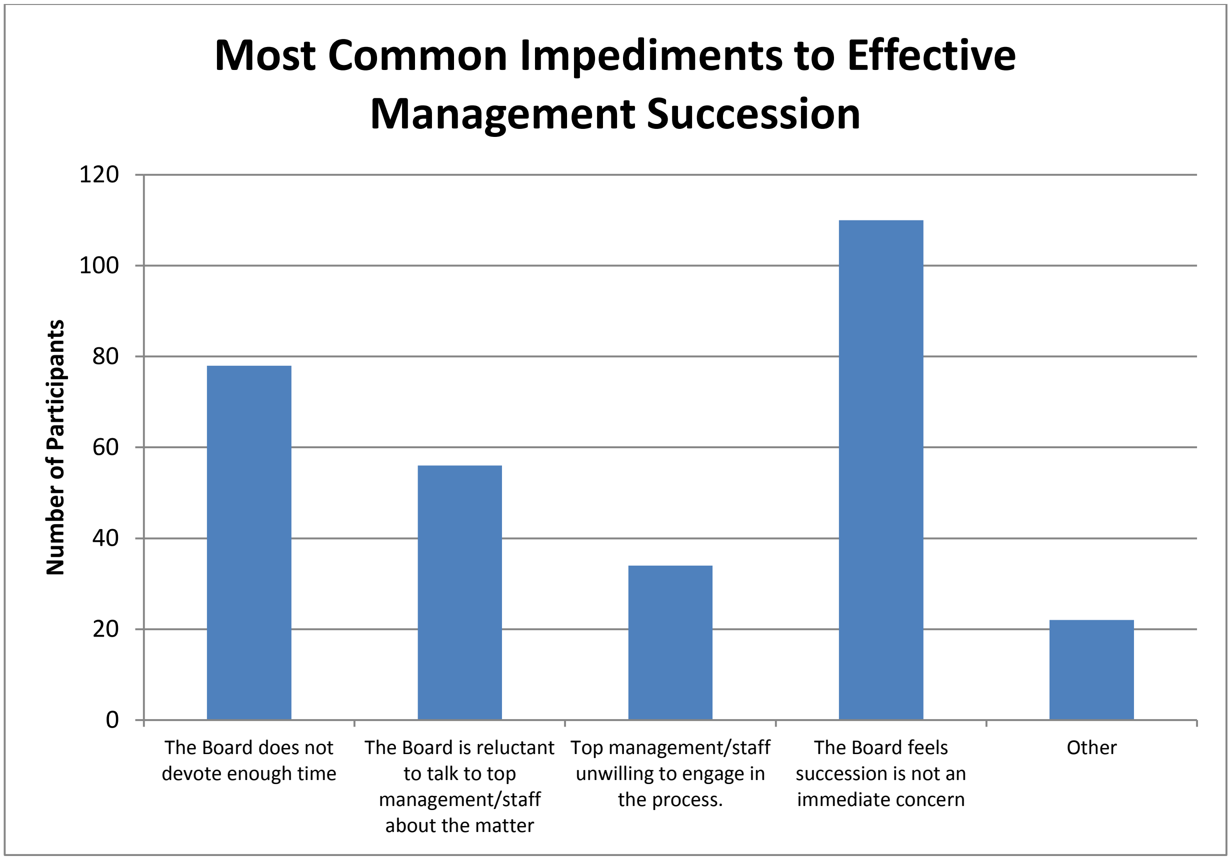

Figure 10 – Impediments to Effective Succession Planning

Our survey asked participants to indicate whether their boards have engaged consultants to assist in the development and/or implementation of succession planning processes. Only 39% of respondents sit on boards that engage succession consultants, with large public companies being most likely (49%) to engage professional advice (See Figure 11 below). Among those whose boards have hired consultants, more than half (59%) felt that the advice they received was helpful. Most participants (79%), however, feel that it is important for boards to implement a formal succession planning process in advance of engaging outside advice in order to maximize the effectiveness of the engagement.

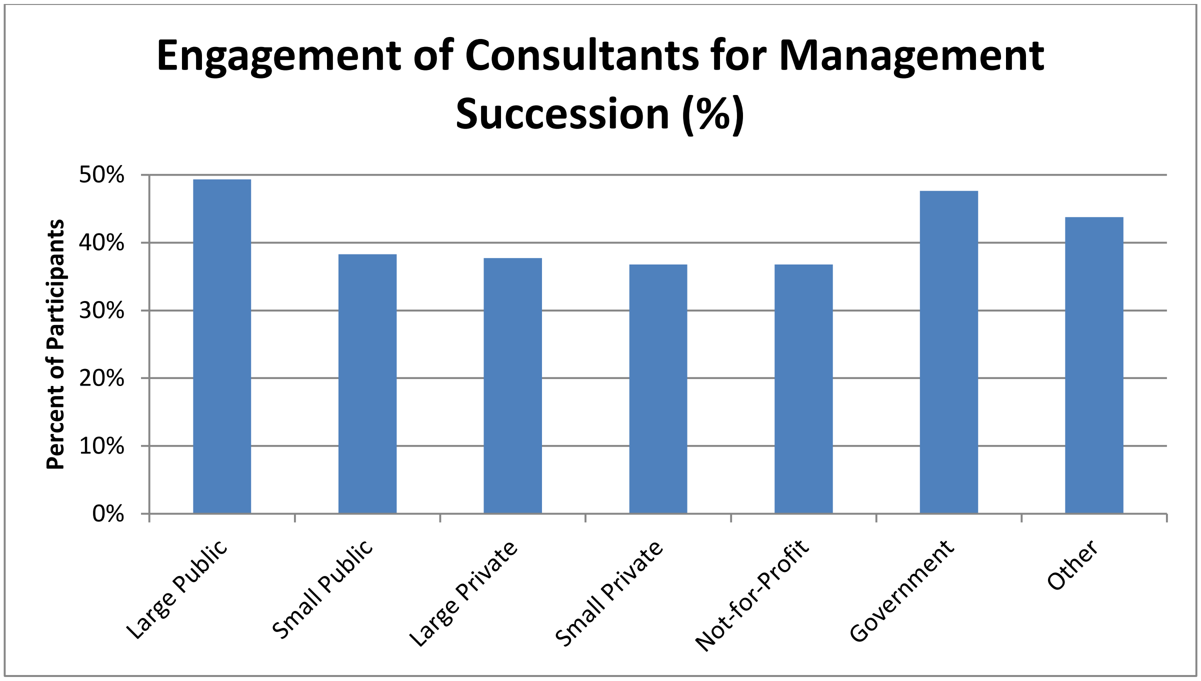

Figure 11 – Engagement of Succession Consultants

Gaps in Resources – Management Succession

Our survey results suggest that when boards are under-prepared for top management succession, it is often because they do not devote adequate attention to the process, rather than being a result of inadequate information or resources. Most of our participants believe that they have access to sufficient resources to guide them in overcoming challenges in succession planning (only 7% disagree).

7. Executive Compensation

Most boards are responsible for developing, implementing and overseeing the compensation of one or more top managers. Highly effective compensation can help to attract the best candidates, and ensure that their behaviour is well aligned with the interests of the organization on an ongoing basis. In recent years, there has been considerably more media attention paid to issues related to executive compensation, particularly pertaining to compensation levels and their alignment with corporate performance. Given this additional attention, compensation has become both a practical and political topic.

In our interviews, Directors indicated that the alignment of pay and performance is an ongoing challenge, particularly when the board is 'under a microscope.' Not all organizations can afford to hire outside advisors, and even when that is an option, we found that Canadian directors are skeptical about the value of such advice. As a result, boards are keen to ensure they are sufficiently effective at compensation oversight prior to the hiring of professional advice.

Our survey asked participants for feedback on their boards' successes in aligning pay and performance, as well as about their engagement of consultants, shareholders, and top managers in the design of compensation philosophies. Although a majority of participants (almost 65%) believe their boards have been successful in aligning executive pay with meaningful performance metrics, this means that more than 35% of boards surveyed continue to struggle in this area. Among participants whose boards have engaged compensation consultants, 59% agreed or strongly agreed that their compensation decision making had improved as a result. Similarly, 66% of participants feel that they receive valuable input from top management while setting executive compensation without compromising the independence of the process. Overall, most survey participants are confident that their boards are able, if allowed to operate without outside interference, to oversee executive compensation in a way that aligns pay with performance.

As media focus and investor scrutiny on executive compensation has increased, alignment between pay and performance continues to be a top investor concern. As a result two key jurisdictions, UK and USA, now have a mandatory shareholder vote on executive compensation, known as 'Say on Pay'. Currently, Say on Pay is voluntary in Canada, and has been adopted by 33 corporations.

When asked about the involvement of shareholders in executive compensation oversight, however, the story is very different compared to shareholder engagement in other areas. Generally, respondents feel that the time horizon for pay/performance alignment is quite long, particularly when dealing with share-based performance (e.g. Total Shareholder Return), and that the interests of many shareholders are too short-sighted to be aligned with the long-term health of a company. Support among our participants for 'Say on Pay' advisory votes is very low, with only 24% agreeing that 'Say on Pay' ought to be mandatory, and 37% agreeing that 'Say on Pay' ought to be voluntary. Moreover, among participants whose boards have previously engaged with shareholders regarding compensation, only 24% felt that they had benefitted from the process. This contrasts directly with a later section where a majority of participants (69%) felt that general board engagement with shareholders is productive (See Section 10 below); indicating that boards feel engagement on executive compensation is less productive than in other areas. All of this suggests a research opportunity into the pros and cons of 'say on pay' to better understand its implications and effects and what the current attitude towards it is, from both the investor and board sides.

Gaps in Resources – Executive Compensation

Most of our participants (63%) feel that they have sufficient access to information and resources to overcome challenges in executive compensation. Boards of smaller public and private companies, however, appear to be struggling to access sufficient comparator data to set meaningful performance metrics. On the one hand, this can be a result of the cost of such data. On the other hand, the performance of smaller companies is often more significantly influenced by market factors (rather than individual performance) compared to larger companies. As a result, directors of smaller firms may benefit from additional tools for the alignment of pay to performance in these unique circumstances.

8. Continuing Education

Our interviews indicate that Canadian directors are concerned that the rapid increase in the complexity of board responsibilities may leave many directors – new and long-tenured – under-equipped to maximize the value they add to their boards. Many of our participants believe that the completion of director education programs has had a significant practical impact on their contributions in the Boardroom.

With regard to new directors, our participants suggested that orientation needs to be sensitive to the challenges faced within particular organizations and particular industries. It is also essential, however, for new appointees to 'do their homework' in order to get themselves up to speed. Our participants' primary concern is for each board member to gain the confidence and knowledge needed to challenge top management and to ask appropriate questions in order to enhance the board's decision-making process. Our interviewees felt that this cannot be achieved if directors do not fully understand their role and the nuances of their particular industry and organization.

Our survey asked participants for feedback regarding the accessibility and quality of continuing education for directors, as well as the practical outcomes of director education. Fewer than half of our participants' boards (47.5%) have formal continuing education policies for their directors. However, a majority of participants (61%) feel that their boards, regardless of whether or not a formal continuing education policy is in place, nonetheless provide valuable opportunities for board members to access education opportunities. Small public, small private and not-for-profit boards offer fewer director education opportunities than their larger counterparts due to the cost of programming and resources.

Fewer than half of our participants (49%) believe that formal director education is sufficient in and of itself to ensure ongoing director effectiveness. Rather, 81% of our participants believe that resources exist beyond director education that can help them maintain ongoing effectiveness as a director.

The impact of director education on our participants' boards has been very positive. There is high confidence among our participants that existing director education opportunities provide practical tools and knowledge (91% agree), and 67% of respondents indicated that continuing education has made their directors more effective.

All of this suggests that there are resources outside of formal director education that are at least as beneficial, if not more so, in ensuring the effectiveness of directors. One possible area of research then would be into what resources and other forms of education are directors using to ensure their effectiveness on an ongoing basis and whether or not they can be applied to other boards.

<u>Gaps in Resources – Continuing Education</u>

A large majority of our participants (82%) agree that Canadian directors have sufficient access to continuing education resources. Several directors from smaller or not-for-profit boards commented that the availability of affordable continuing education is limited, and that their board members are unable to participate as a result.

9. Risk Management

In our interviews with Canadian directors, the topic of risk was generally raised in the context of the economic downturn of 2008. One of the many effects that this event had on Canadian boards is an increased focus on monitoring risk, including preparing for the possibility of future economic crises.
Historically, many boards have considered risk in purely financial terms, and, such being the case, boards' oversight of risk was primarily handled by audit committees. However, our interviews indicate that directors now see risk as involving a complex combination of many diverse financial and non-financial factors. But many Directors continue to worry that risk is too often addressed only in financial terms, and they see this as an issue of growing importance.

Our survey asked participants to describe the effectiveness of their boards' risk management oversight, including how responsibility for this process is delegated. A majority of participants (71%) are confident that their boards provide effective oversight of material strategic risks. Generally, the responsibility for risk management is borne by the board as a whole and by the audit committee (See Figure 12 below), while senior management contributes to risk oversight in 33% of responding boards; most commonly in not-for-profits.

Figure 12 – Who is Responsible for Risk Management?

Although confidence in the effectiveness of risk management oversight is high, fewer than half of respondents (49.7%) indicated that their boards provide effective 'downside' planning, thus leaving them under-prepared for negative outcomes/events.

<u>Gaps in Resources – Risk Management</u>

Among all subject areas covered in our survey, confidence in the value of tools and resources available to Canadian boards for Risk Management was one of the lowest numbers. Only 59.6% of participants agreed that Canadian boards have access to useful resources to assist in risk management oversight. Respondents indicated that risk is often mistakenly understood to mean only *financial* risk, and that resources are required to help boards in all sectors better understand that risks in all areas (strategy, technology, reputation, safety, etc.) are variable from company to company, and are under the board's purview. As a result, it would be beneficial for boards to have access to practical tools or guides to help integrate risk management into non-financial discussions as well as provide clarity on the relationship between risk management and other key board functions.

10. Change of Control Oversight, Proxy Voting, Shareholder Engagement

The evolution of best practices in corporate governance since the major corporate meltdowns of the turn of the millennium has resulted in increased engagement between boards and investors. Shareholders, particularly large institutional investors, are becoming more hands-on with boards, as the expectations regarding active board oversight of shareholder interests' rise. Although there is little consensus among our interview participants regarding the value of this trend, the general consensus is that it is here to stay.

This section of our survey was predominantly relevant to publicly-traded corporations. We asked participants for their feedback on the effectiveness of their boards' oversight of change of control, engagement with shareholders, and the Canadian proxy voting system.

Change of Control

A large majority of participants (83.5%) were confident in their awareness of their boards' responsibilities in a change of control. Confidence in the division of responsibilities between boards and regulators was not as strong (57%).

Shareholder Engagement

Most participants (69%) believe that their engagement with shareholders is productive. Similarly, our participants believe they are generally able to meet their shareholders' expectations during engagements. Some participants indicated concern that engagement with shareholders ought to be avoided by boards unless absolutely necessary as it can be a time drain, and can 'muddy the waters' in terms of board priorities.

Gaps in Resources – Shareholder Engagement

Most participants (70%) believe their boards have sufficient access to tools and resources to assist in optimizing the effectiveness of shareholder engagement. Some suggested additional resources include:

- Increased availability of shareholder information (i.e. who owns the shares)

- More formalized processes for boards to engage with large shareholders in aggregate – perhaps through the Canadian Coalition for Good Governance

Proxy Voting

Although respondents on publicly-traded boards are slightly more confident than others, only 52% of participants feel that their boards fully understand Canada's proxy voting system. Moreover, confidence in the effectiveness and accuracy of vote counting is very low: only 42% of participants agreed or strongly agreed that the outcomes of close votes fairly reflect the views of shareholders. Many of our participants feel that the effectiveness of the voting system is further compromised by the influence of proxy advisory firms, and that boards have insufficient influence on the recommendations these firms provide. Directors have indicated that there is a significant gap in their understanding of the proxy voting process and they would benefit from research that would help define how the proxy voting system in Canada functions. Additional research into the accuracy of close voting would also be highly beneficial.

Gaps in Resources – Proxy Voting

Confidence in existing resources available to Canadian boards is quite low in this area, with only 52% of participants indicating that they feel they have access to helpful tools and information. That said, most of our respondents were unable to provide recommendations regarding what tools would be helpful. Several participants suggested that increased transparency in the proxy advisory process would be a great benefit to boards, and would provide them with the opportunity to address shareholder concerns in order to limit the likelihood of negative voting outcomes.

11. Director Liability

One crucial by-product of the increased scrutiny and regulatory pressure that boards now face is the ever-increasing complexity of personal liability for directors. Our interview participants indicated that they are aware that they are personally exposed to liability in many areas, but also worried that they are not fully aware of the specific risks they face, or of the potential gaps in their insurance coverage. New and existing directors must have working knowledge of their liabilities and must understand the D&O insurance currently covering their respective boards, but many directors feel they must dive deeper into the issue in order to ensure they are sufficiently protected.

Our survey asked participants for feedback on their understanding of the liability to which Canadian directors are exposed. A large majority of participants (77%) indicated that they are confident in their awareness and understanding of their fiduciary duties as directors, and also that they strongly believe (89%) that they or their fellow directors would 'blow the whistle' if necessary in cases of fraudulent behaviour. In addition, most participants (60%) feel they are aware of the frequency of lawsuits brought against Canadian directors, indicating a keen awareness of the likelihood that they may be involved in litigation themselves. On this last point, however, there was a larger than average sample (23%) that disagreed or strongly disagreed that they are aware of the frequency of director litigation, suggesting that there may be important work yet to be done.

<u>Gaps in Resources – Director Liability</u>

Our participants indicated that they feel access to tools and resources regarding director liability is quite high, although not always sufficiently specific. Recommended resources included:

- Regularly updated summaries of Canadian case law
- Guidance for boards to make the best use of their board-appointed lawyers

12. Director Compensation

Director compensation is not something that all boards need to address as not all boards compensate their directors. In those cases where directors are compensated, however, it is used to reward directors for their time and expertise.

In this section, our survey asked participants for feedback regarding the fairness and effectiveness of director compensation behaviour on Canadian boards. Although most participants (68%) believe that compensation offered by their boards is fair, only 39% feel that this compensation helps to attract the right board members. Given that 70% of participants are confident that their boards have the right balance of skills in order to be effective, this shows that boards are doing a good job of appropriately compensating for directors' time while at the same time getting directors who are not simply 'doing it for the money'. Notably, participants from government boards demonstrated the lowest confidence in both the fairness of director compensation and the attractiveness of director compensation to new board members, indicating ongoing difficulties with director compensation arrangements on government boards. Further, only 37% of participants agreed that tax rules on director compensation are fair, indicating concern with the fact that Canadian director compensation is taxed as though board members are employees.

<u>Gaps in Resources – Director Compensation</u>

Although most participants (68%) agreed that they have sufficient access to tools and information to assist in the development and design of director compensation, it was suggested that the availability of comparative peer information would be helpful.

APPENDIX I: Study Methodology

In early 2011, the Canadian Foundation for Governance Research (CFGR) commissioned the Clarkson Centre for Board Effectiveness (CCBE) to undertake a study of challenges currently facing Canadian corporate directors. The goal of this endeavour was to identify current governance issues that would most benefit from future study.

We began our process with one-on-one telephone Interviews between CCBE staff and Canadian directors from various sectors and regions, many of whom are current ICD members. Our goal was to identify which governance topics and concerns currently pose the most high-priority challenges to Canadian boards and directors. The interviews were largely unscripted in order to allow participants to direct the discussion toward governance topics of particular importance and relevance to their experience. Several key challenge areas were identified through the interview process and these formed the framework for an online survey which, in partnership with the ICD, was distributed to the ICD members to gather quantitative feedback on key governance topics. The purpose of the survey was threefold:

1. Quantitatively identify the most important challenges currently being faced by Canadian directors in the boardroom.
2. Determine if directors are aware of the tools and information resources available to them
3. Assess whether or not directors feel that these tools and information resources are sufficient to help them overcome these difficult challenges

CCBE based the content of this survey primarily on the preliminary interviews conducted with 44 Canadian directors who represented diverse industries and sectors. The feedback we received from these directors resulted in the identification of seven broad topics. For the purpose of our survey, we broke these down further into 13 areas of immediate concern to Canadian directors:

Director Recruitment

- Board composition
- Director diversity

Board Independence

- Board effectiveness and evaluations
- Boardroom decision-making
- Board-management relationships
- Director Compensation

Succession Planning

Executive Compensation

Director Education

Risk Management

- Board oversight of risk
- Board oversight of change of control

Director Liability

Shareholder Engagement

These formed the focal points of our director survey, which was completed by 304 Canadian directors in February and March, 2011. In addition, by comparing the results from this survey to the CCBE's governance database, we identified several areas where survey participants indicated high confidence while real-world behaviour indicates otherwise. A summary of our survey results is provided in this document.

Concurrently with the delivery of our survey, the CCBE, with support from the Business Information Center (BIC) at the Rotman School of Management, conducted a broad scan of existing literature, research and reports that focus on the topics identified through our director interviews. The goal of the literature scan was twofold:

1. Identify, if applicable, gaps in existing literature where new research would most benefit corporate directors
2. Identify what topics, if any, directors are struggling with despite an abundance of relevant and useful research and tools.

The accompanying document *CFGR-CCBE Literature Review Report* details the findings of the literature review process, and lists recommended resources to help directors overcome key challenges, as well as highlighting important gaps in existing governance research. We are reasonably confident that, while it is impossible to review the entire body of literature that exists on corporate governance, the insights we present in the literature review report have considered a highly relevant cross-section of extant literature and research.

Following the close of the online survey, we conducted 7 follow-up interviews focusing on three key areas where we felt we could benefit from further qualitative insight.

- Risk management and board time allocation
- The importance of Chair effectiveness
- Shareholder engagement on compensation compared to shareholder engagement on other topics

Generally, these interviews validated our findings from the survey, and any new insight has been integrated into the accompanying document, *2011 CCBE Research Recommendations*.

2011 CCBE Research Recommendations considers the findings of this entire study and provides recommendations for specific targeted governance research areas with the goal of filling gaps we have identified in existing literature; specifically in areas of particular concern to Canadian directors.