CHAPTER 05

In Focus: Building High-Performing Boards

Building a high-performing board of directors has never been more important and more complex. The rise in shareholder activism, the increased scrutiny over environmental, social and governance issues and their oversight, and the growth of disruptive technologies are only a few of the reasons effective board governance is becoming an area of acute focus. Meanwhile, the corporate governance landscape has grown more complicated, making it increasingly difficult for directors to manage the sometimes inconsistent and evolving demands of multiple constituencies while also fulfilling their fiduciary duties. In this chapter, we take an in-focus look at a wide range of legal requirements, guidance and governance best practices aimed at helping issuers maximize the quality and effectiveness of their boards of directors.

Introduction

In an effort to help Canadian issuers build high-performing boards, this chapter synthesizes many of the requirements and guidelines for board composition from corporate law, the Canadian securities regulators and the Toronto Stock Exchange (TSX). We also discuss a number of relevant recommendations from Glass, Lewis & Co. (Glass Lewis), Institutional Shareholder Services, Inc. (ISS) and the Canadian Coalition for Good Governance (CCGG) relevant to directors' skills, qualifications and commitment. Throughout, we explore the best practices and current trends with respect to the composition of Canadian public company boards, focusing on director qualifications and skills, board commitment and overboarding, director tenure policies, board size, independence requirements, diversity and board committees.

Director Qualifications and Skills

LEGAL REQUIREMENTS

For companies incorporated under the *Canada Business Corporations Act* (CBCA) and the *Business Corporations Act* (Ontario) (OBCA), a director must be an individual who is at least 18 years of age, competent and not an undischarged bankrupt.[96] At least 25% of the directors of CBCA and OBCA companies must generally be Canadian residents and, unless the articles state otherwise, an individual need not hold shares in the company to be elected as a director. Director eligibility requirements vary by province and are set out in the corporate statutes of the province where the company exists.

BOARD COMPOSITION TOPICS

- Director Qualifications and Skills
- Board Commitment and Overboarding
- Director Tenure Policies
- Board Size
- Independence
- Diversity
- Committees

BEST PRACTICES AND TRENDS

Aside from the above requirements, there are few other prescriptive rules regarding director skills and qualifications. Having high-quality directors, as cited by CCGG, is of course a critical corporate governance requirement, with CCGG defining a director of quality as "someone with integrity, expert knowledge, business, industry or other relevant experience and with the time and motivation to understand and carry out his or her fiduciary duties in the long-term best interests of the company and all its stakeholders."[97]

Although having quality directors should be a top concern, the ideal composition of any board will ultimately depend on many company-specific variables, including the type and size of the company, the industry and a director's "fit" with the board. The following sections outline some recommended best practices for achieving a strong mix of director skills and experience.

SKILLS AND COMPETENCY MATRICES ON THE RISE

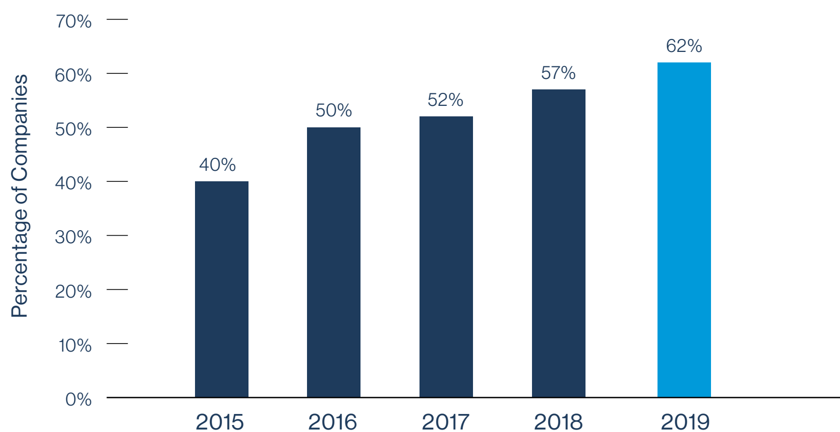
Skills and competency matrices have become an important and valuable tool in recent years, with many public companies using them to showcase the skills, experiences and capabilities of their current boards and to assist in shaping the future composition of their boards. A skills and competency matrix visually demonstrates the competencies and skills that the board, as a whole, should possess as well as which of those competencies and skills each incumbent director possesses.

As evidenced by Figure 5-1, there has been a steady increase since 2015 in the use of skills and competency matrices, with 62% of issuers from our study sample on the Composite Index and SmallCap Index currently disclosing a skills and competency matrix. Glass Lewis updated its 2019 proxy voting guidelines for TSX-listed issuers, stating that board skills matrices will be considered in its formulation of director voting recommendations at TSX 60 companies.[98] Canadian public companies, and especially TSX 60 issuers, should therefore consider developing and disclosing a skills matrices in their proxy circulars.

GUIDANCE FOR PREPARING A SKILLS MATRIX

- Identify the skills, competencies, experiences and backgrounds required to address both existing and emerging business needs
- Create specific qualifiers (i.e., breadth and depth of skills and experience required) for each skill and competency
- Define how many directors should have each skill and competency
- Map both existing and potential directors to the skills required
- Solicit feedback and approval from the entire board
- Integrate the matrix into the director renewal process
- Ensure the board critically examines the matrix on a regular basis (i.e., annually)

FIGURE 5-1:
Percentage of Issuers on the TSX Composite and SmallCap Indices Disclosing a Skills and Competency Matrix (2015–2019)



There are no specific content requirements for a skills and competency matrix, but Glass Lewis has indicated that a company should disclose sufficient information to allow investors to make a meaningful assessment of a board's overall skills and competencies. The type and scope of disclosure varies, with some companies identifying a director's top three to five skills, and other companies distinguishing between directors who are experts and directors with general or limited experience in a particular area. Furthermore, CCGG's *2018 Best Practices for Proxy Circular Disclosure* notes that companies should disclose the key skills they require from their directors as well as the company's priorities, preferences and criteria when searching for new directors.[99] CCGG's recommendations are also consistent with the Canadian Securities Administrators' (CSA) recommended best governance practices.[100] Increasingly, and as discussed in *Davies Governance Insights 2018*,[101] issuers are also being encouraged to include information in their matrices regarding each director's tenure and various diversity-related factors.

DIRECTORS WITH POOR PAST PERFORMANCE TO BE AVOIDED

Often guided by the recommendations of ISS and Glass Lewis, shareholders are increasingly voting against directors who have served on boards, or as executives, of companies with a history of poor performance, inadequate risk oversight, excessive compensation, audit or accounting issues and/or other examples of mismanagement or governance failures not aligned

with the interests of shareholders. Glass Lewis also recommends that shareholders vote against directors who have a history of not fulfilling their responsibilities to shareholders at any company where they have served as a director or executive.[102] For example, Glass Lewis recommends voting against the following:

– a director who fails to attend a minimum of 75% of board and/or committee meetings without a reasonable explanation;

– a director who is also the CEO of a company where a serious and material restatement has occurred after the CEO had previously certified the financial statements;

– a director who has received two "against" recommendations from Glass Lewis for identical reasons within the past year at different companies; or

– a director who exhibits a pattern of poor oversight in the areas of executive compensation, risk management or director recruitment/nomination.[103]

INCREASES IN THE NUMBER OF FIRST-TIME DIRECTORS

There has been a growing trend toward first-time non-executive directors serving on boards. This has been largely driven by an increased demand for specific skill sets and as a means to correct gender and ethnic imbalances.[104] We expect this trend to continue in the coming years, with companies seeking directors with particular knowledge in fields such as cybersecurity, artificial intelligence, machine learning, digital transformation, customer insight, human resources/compensation, climate change and social communications.

Board Commitment and Overboarding

Board service requires significant time and attention in order for a director to properly discharge his or her responsibilities, often ranging from 200 to 300 hours a year, plus the additional time required to chair and/or serve on committees. It is essential that nominating committees take into account the demands on directors' time. In assessing whether a candidate has the time and energy needed for board service, practices and policies have largely focused on "overboarding." Overboarding refers to situations in which a director serves on an excessive number of boards. Overboarding practices and policies to date have largely been driven by guidelines from proxy advisory firms and institutional investors, and have focused on imposing a limit on the number of public company boards on which a member of the board may serve.

ISS AND GLASS LEWIS GUIDELINES

In 2019, ISS again modified its proxy voting guidelines for TSX-listed companies concerning the number of permissible directorships that a director may hold before being overboarded. A director will be overboarded if, in the case of a CEO, he or she sits on more than two public company boards (including the company of which he or she is CEO); and in the case of directors other than the CEO, he or she sits on more than five public company boards.[105] In contrast to ISS's previous policy, ISS no longer considers a director's attendance record when determining to recommend voting against a director who is overboarded.

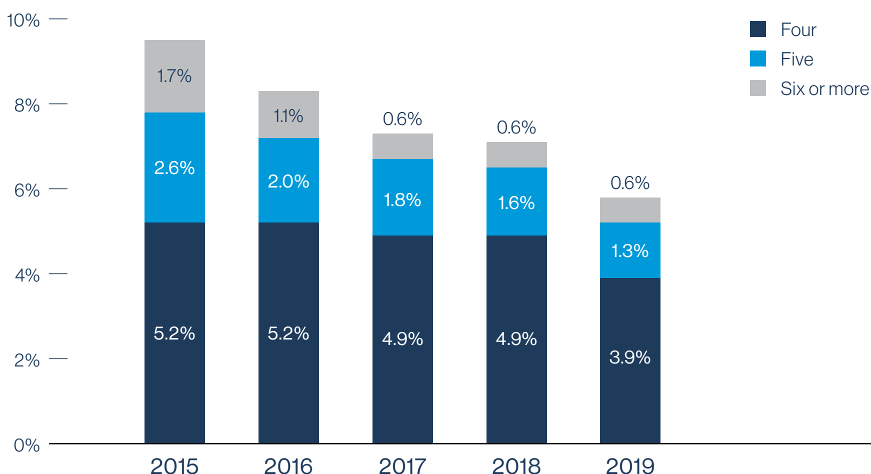
ISS and Glass Lewis are now fairly aligned with respect to their Canadian overboarding policies. Subject to certain exceptions, Glass Lewis will generally recommend a withhold vote from a director nominee if, in the case of an executive officer, he or she serves on more than two public company boards; and in all other cases, he or she serves on more than five public company boards.[106] For TSX Venture Exchange (TSXV) companies, Glass Lewis will generally permit directors to sit on up to nine boards.

TRENDS IN BOARD SERVICE

As depicted in Figure 5-2, fewer directors on Composite Index and SmallCap Index boards are serving on four or more boards today compared with prior years. These findings are not surprising considering the increasing demands placed on directors.

While the correlation between company performance and the number of overboarded directors is not necessarily clear, a recent ISS study in the United States on Russell 3000 companies found that companies without any overboarded directors had stronger economic performance than company boards with overboarded directors.[107] For the purposes of that study, an overboarded director was a CEO who served on more than two public company boards (including the company of which he or she was CEO) or a non-CEO director who served on more than four public company boards.

FIGURE 5-2:
Percentage of Directors Serving on Four or More TSX Composite and SmallCap Indices Boards (2015–2019)



Our Take: Scrutinize Directors' Motivation and Capacity to Serve

Prior to a director's appointment, all significant commitments, including other public company, private company and not-for-profit directorships, should be disclosed to the board and continuously reviewed and updated in assessing directors' performance. Although the time commitment and demands of serving as a director have likely never been greater than they are today, of course having experience serving on multiple boards can be a valuable opportunity for directors and the value of those experiences should be considered when determining overboarding policies. Looking ahead, we expect even greater investor scrutiny of directors' time commitments. Regardless of whether overboarding guidelines are appropriate proxies for determining whether a board member has sufficient time to properly discharge his or her responsibilities, we recommend the following best practices:

- Implement a formal policy on overboarding that is at least as restrictive as the ISS and Glass Lewis guidelines.
- Ensure the overboarding policy is followed when identifying and screening new directors.
- Require directors to seek prior approval from the board chair before joining any other board (which is also important for reducing or eliminating possible "interlocks" between directors, discussed further below).
- Regularly review director nomination and evaluation processes to ensure that they properly account for all of the board and committee commitments of a director.
- Ensure you understand the issuer's significant shareholders' views on overboarding, especially since many institutional shareholders have their own overboarding policies that may be more restrictive than the ISS and Glass Lewis guidelines.

Director Tenure Policies

LEGAL REQUIREMENTS

Under Canadian corporate law, directors may be elected for a term of up to three years, and staggered boards are often technically permitted. However, the TSX requires annual elections for all directors of TSX-listed companies, effectively preventing staggered boards for those issuers.[108] Although there has been increasing demand from some investors for issuers to impose term limits on directors, there are currently no statutory limits on the number of terms that a director can serve.

Nonetheless, often in an effort to foster board renewal and improve diversity, many Canadian public companies have implemented director tenure policies, with the most common policies being term limits and mandatory retirement policies. Term limits impose a maximum amount of time that a director may serve on a board, whereas mandatory retirement policies set an age limit for directors. Consistent with prior years, for issuers on the Composite Index and the SmallCap Index that have retirement policies and/or term limits, the average retirement age is 73 years and the average term limit is 13 years.

The most commonly cited advantages and disadvantages of term limits and retirement policies are as follows:

Pros

- Allow continued refreshment of directors
- Ensure board remains responsive to changing business needs and company performance
- Minimize shareholder concerns over director independence since directors are not entrenched
- Provide opportunity to enhance diversity
- Avoid difficult conversations with long-tenured directors who are underperforming or no longer providing value
- Bring fresh perspectives and reduce complacency

Cons

- Arbitrary policies eliminate experienced and potentially valuable directors
- Eliminate both effective and non-effective directors
- Long-tenured directors provide significant value, including experience, institutional knowledge and familiarity with the business
- Create an expectation that a director will serve until mandatory retirement age or tenure limit is reached

Canadian securities regulators have not adopted formal rules or regulations with respect to director tenure policies. Under National Instrument 58-101 – *Disclosure of Corporate Governance Practices* (NI 58-101) and the CBCA amendments discussed in Chapter 1, CBCA Reforms: Canadian Government Codifies Corporate Governance Practices, Canadian public companies are required to disclose only whether or not they have adopted director tenure policies or other mechanisms of board renewal and, if so, a description of the policies. If the company has not adopted such policies, it must disclose the reasons for not doing so.

TRENDS IN TERM LIMITS AND RETIREMENT POLICIES

As of 2019, 35% of Composite Index and SmallCap Index issuers had adopted a director tenure policy of some form. Of these, 45% had mandatory retirement policies, 20% had term limits and 35% had both term limits and mandatory retirement policies. These results are largely consistent with prior years, with only a marginal increase since 2015 in the number of issuers in our study sample that have adopted director tenure policies – 35% in 2019 compared with 32% in 2015.

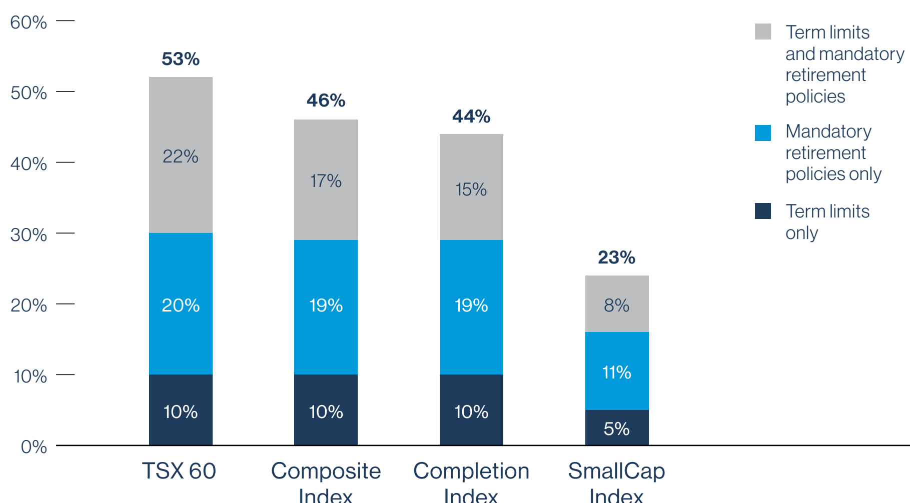
Figure 5-3 shows a breakdown of the adoption of director tenure policies by TSX 60, Composite Index, Completion Index and SmallCap Index companies. Significant takeaways include the following:

– Not surprisingly, TSX 60 issuers represent the highest proportion of companies with director tenure policies (53%).

– The proportion of issuers with director tenure policies declines as their market cap declines, with only 23% of SmallCap Index companies having a director tenure policy.

– Mandatory retirement policies are the most common form of tenure policy for each market cap tier except for TSX 60 companies, for which both term limits and mandatory retirement policies are common.

FIGURE 5-3:
Percentage of Issuers with Director Tenure Policies by TSX Index (2019)



BEST PRACTICES: DEVELOP ROBUST DIRECTOR ASSESSMENT PROCESSES

Despite the absence of formal regulation, proxy advisory firms, governance experts and other market participants generally support issuers' maintaining robust director assessment processes, as opposed to term limits or mandatory retirement policies. In particular, Glass Lewis, ISS, CCGG and the Institute of Corporate Directors (ICD) all advocate against the use of term limits and mandatory retirement policies as the principal means for ensuring high-performing boards.

We also recommend that issuers implement robust assessment processes that require boards, committees and individual directors to be evaluated at least annually, or more frequently in the event of material changes in their performance or circumstances. Although most issuers annually disclose, as required under NI 58-101, that they have such processes, in our experience there is a wide divergence in their relative robustness. For companies looking to balance the need for renewal and fresh perspectives on their board with the desire to maintain experience and institutional memory, we recommend the following:

1. Have a robust assessment process. Review your annual board assessment processes and enhance the robustness of your assessment questionnaire. Ensure the independent board chair or lead director meets one-on-one with each director to get their views concerning their own and other directors' performances.

2. Require notice of material changes in circumstances. Require directors to provide prompt notice to the board chair when they experience a material change in their circumstances, to assess whether those changes may affect the performance of their duties on the board and its committees.

3. Consider independent external reviews. For boards that have a high number of long-tenured directors and/or difficulty in assessing and addressing potential performance issues, consider engaging an outside "board doctor" to conduct the assessment and make recommendations to the board.

4. Consider whether tenure limits are appropriate. For some companies, term limits and/or retirement policies may be appropriate. Companies that already have or are considering implementing such policies should consider the views of their significant shareholders and of proxy advisory firms; be aware that while most policies permit waivers of the applicable tenure requirement, doing so may trigger negative voting recommendations from ISS and/or Glass Lewis. As an alternative, consider imposing limits on the period of time a person may serve as chair or lead director of the board or as a committee chair.

5. Assess independence based on tenure. As discussed further below, tenure is a factor that should be relevant to a board's consideration of whether a director continues to be independent. While not necessarily the case, boards should consider whether the length of a director's tenure could reasonably be expected to interfere with the director's exercise of judgment.

Glass Lewis recommends that boards of TSX-listed issuers have a minimum of five directors to ensure sufficient diversity of views and experience, and a maximum of 20 directors to ensure that decisions are made efficiently and effectively.

6. Consider director voting outcomes. Boards should take seriously, and investigate, circumstances in which one or more directors receive relatively lower levels of support for their election at annual shareholders' meetings. While voting outcomes may not necessarily correlate with the director's performance or commitment, they are indicators of investors' views of an issuer's directors; sustained lower level votes over more than one year are likely important signals that refreshment may be necessary.

Board Size

LEGAL REQUIREMENTS

The composition of a company's board is governed by the corporate laws of the jurisdiction where the company exists. In Canada, generally public companies must have at least three directors.

ISS AND GLASS LEWIS GUIDANCE

Although there is no universally accepted ideal board size in Canada, Glass Lewis recommends that boards of TSX-listed issuers have a minimum of five directors to ensure sufficient diversity of views and experience, and a maximum of 20 directors to ensure that decisions are made efficiently and effectively. Glass Lewis will generally

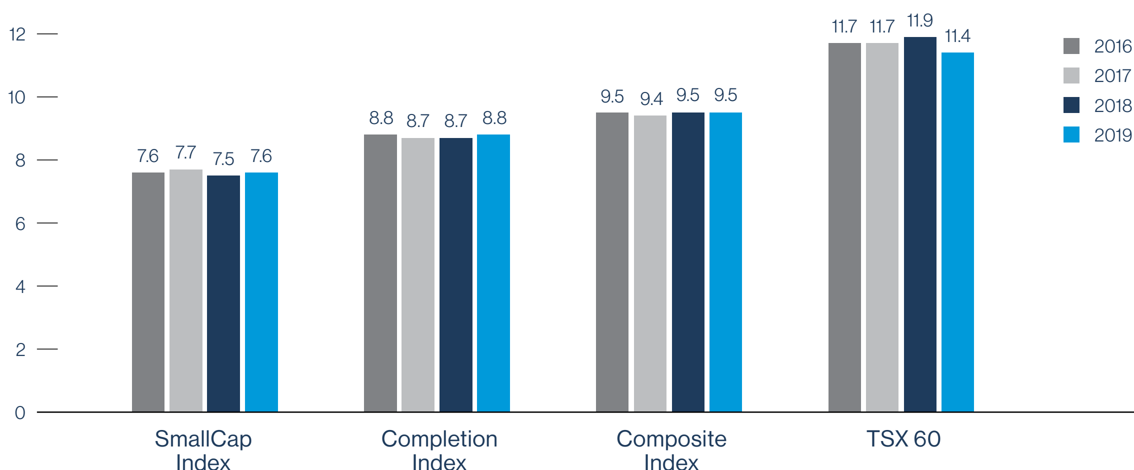
recommend withholding votes from the chair of the nominating and/or governance committee (or the board chair in the absence of such committees) at TSX companies with fewer than five directors and TSXV companies with fewer than four directors. For boards with more than 20 directors, Glass Lewis will generally recommend withholding votes from the chair of the nominating committee (or the governance committee in the absence of a nominating committee).[109]

ISS does not provide organizations with guidance on board size other than noting that boards should be large enough to accommodate diversity, expertise and independence, yet small enough to maintain active collaboration and participation.[110]

TRENDS IN BOARD SIZE

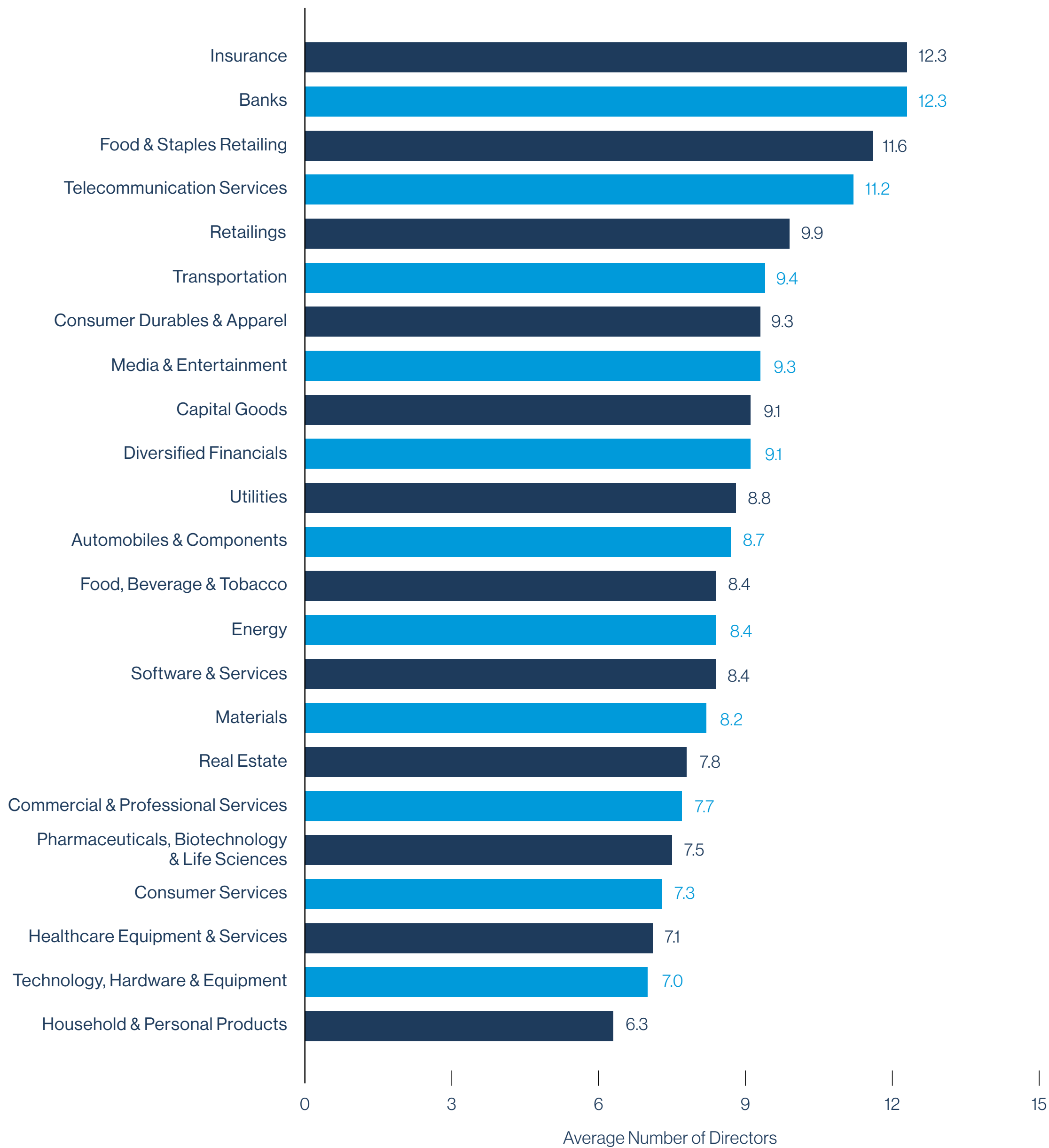
As shown in Figure 5-4, issuers on the Composite Index and the SmallCap Index combined typically have an average of between seven and 12 directors. The average board size of issuers generally increases as the market cap of the issuer increases. In 2019, the average board size of an issuer in our study sample was nine directors, with the size of such boards ranging between three and 16 directors (except for one company that had 22 directors). The majority of issuers across all four indices had a board size of between seven and nine directors.

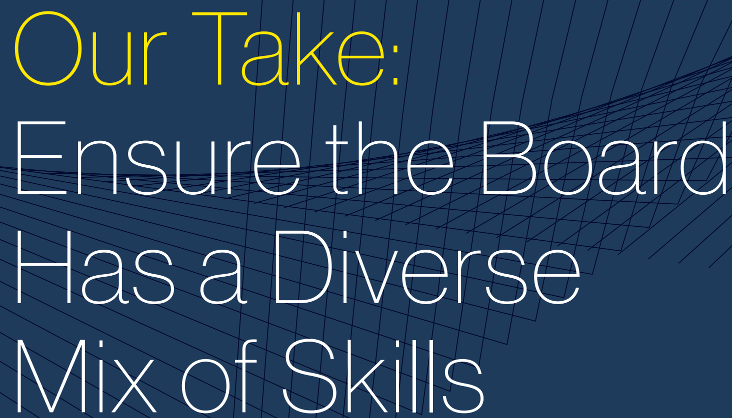
FIGURE 5-4:
Average Board Size by TSX Index (2016-2019)



As depicted in Figure 5-5, the average board size of issuers on the Composite Index and the SmallCap Index varies by industry, with those in insurance, banking, and food and staples retailing having the largest boards; those in households and personal products, technology hardware and equipment, and healthcare equipment and services have the smallest boards.

FIGURE 5-5:
Average Board Size by Industry on TSX Composite and SmallCap Indices (2019)





Our Take: Ensure the Board Has a Diverse Mix of Skills

At the end of the day, the ideal size of a board will vary by company and depend on a range of factors, including market cap, the complexity of the company's business, the company's strategy and plans, geographical footprint, required skills and the presence of significant or controlling shareholders that may have board nomination rights. Studies have indicated that smaller boards outperform larger boards for several reasons, including the fact that smaller boards can be more decisive and cohesive, and can foster better debates, more efficient decision-making and more effective management oversight.[111] That said, the key factor in determining the right board size will be to ensure that the board has the right mix of skills, knowledge and experience to guide a company in the proper direction. To do so, we recommend that boards develop, implement and annually review (and if appropriate, revise) a robust skills and competency matrix, having regard to the business's evolving needs and strategies. Doing so often better situates companies to both assess the effectiveness of their current boards and ensure that new directors are selected objectively in furtherance of creating a high-performing board.

Independence

> Although the TSX and the Canadian securities regulators have slightly different definitions of independence, they are both concerned with relationships that could interfere with a director's ability to act objectively and without bias, and to fulfill their fiduciary duty to act in the best interests of the company.

OVERVIEW OF INDEPENDENCE CRITERIA

The need for independent directors on Canadian public company boards is a well-established principle, with securities regulators and the TSX providing specific regulation and many proxy advisory firms offering additional guidance, which influences their voting recommendations. The principal purposes of director independence requirements are to help ensure that directors' interests are aligned with the shareholders' interests as opposed to management's and to help boards maintain objectivity in their strategic decision-making.

Canadian securities regulators, through NI 58-101, National Policy 58-201 – *Corporate Governance Guidelines* (NP 58-201) and National Instrument 52-110 – *Audit Committees* (NI 52-110), have defined an independent director as an individual who has no direct or indirect "material relationship" with the company; a material relationship is any relationship that could, in the view of the company's board, be reasonably expected to interfere with the exercise of such director's independent judgment. NI 52-110 sets out a number of relationships between a director and the issuer that are deemed to give rise to a material relationship, including where a director is or has been an employee or executive officer of the issuer or a subsidiary of the issuer within the last three years, and advisers or consultants to the issuer, such as lawyers, accountants and bankers.

The TSX defines an independent director as an individual who (i) is not a member of management and is free from any interest and any business or other relationship that in the opinion of the TSX could reasonably be perceived to materially interfere with the director's ability to act in the best interest of the company; and (ii) is a beneficial holder, directly or indirectly, or is a nominee or associate of a beneficial holder, of 10% or less of the votes attaching to all issued and outstanding securities of the company. The TSX considers all relevant factors in assessing the independence of a director; however, as a general rule, the following are not considered independent: (i) a person who is currently, or has been within the past three years, an officer, employee of or service provider to the company or any of its subsidiaries or affiliates; or (ii) a person who is an officer, employee or controlling shareholder of a company that has a material business relationship with the company.[112]

Although the TSX and the Canadian securities regulators have slightly different definitions of independence, they are both concerned with relationships that could interfere with a director's ability to act objectively and without bias, and to fulfill his or her fiduciary duty to act in the best interests of the company. ISS, Glass Lewis and CCGG, among others, have published additional definitions of independence; while their definitions are generally consistent with those above, with lookback periods varying between three to five years, they also include several additional indicia that may render a director not independent under their policies.

BEST PRACTICES: MAINTAIN A MAJORITY INDEPENDENT BOARD

1. Ensure compliance with independence standards for boards. Table 5-1 outlines the minimum independence requirements set out by the CBCA, the OBCA, the CSA, the TSX, ISS, Glass Lewis, CCGG and *The Globe and Mail*'s Board Games Report. The general recommendation is that boards should have a majority of independent directors. Notable exceptions include the following: (i) CCGG recommends that at least two-thirds of a board be independent; (ii) *The Globe and Mail*'s Board Games Report provides full "marks" only for boards that are two-thirds independent (half marks for boards that have a majority of independent directors and zero marks if a majority of the board is not independent); and (iii) Glass Lewis recommends that at least two-thirds of a board for Composite Index issuers be independent.

TABLE 5-1:
Minimum Canadian Independence Requirements

Guidelines	Two Independent Directors	One-Third Independent Directors	Majority Independent Directors	Two-Thirds Independent Directors
CBCA (Public Companies)*	✓			
OBCA (Public Companies)**		✓		
Canadian Securities Laws (NP 58-201; NI 52-110)			✓	
TSX (TSX Company Manual)	✓			
ISS			✓	
Glass Lewis (General)			✓	
Glass Lewis (Composite Index)				✓
CCCG				✓
The Globe and Mail's Board Games Report (2018)[113]	Full "marks" (four marks) are awarded for a board that is two-thirds independent. Two marks are awarded if more than half of the board is independent. Zero marks are awarded if the majority of the board is not independent.			

* A CBCA public company must have at least two directors on its board who are not officers or employees of the company or any of its affiliates.

** An OBCA public company must have at least one-third of the directors on its board who are not officers or employees of the company or any of its affiliates.

Although independent directors play an important role, the general consensus from proxy advisory firms is that boards should not be entirely composed of independent directors since company executives (present or former) have certain company-specific knowledge and experience that make them extremely valuable board members. Since a director's independence can change over time, boards should review the proportion of independent directors on an annual basis to ensure that the appropriate minimum thresholds are continuously achieved.

When conducting independence assessments, many boards focus on the "bright-line" relationship tests in NI 52-110. It is important to remember that this is only part of the picture. The objective test in NI 52-110 that requires boards to consider whether there is any other relationship that could reasonably be expected to interfere with the exercise of a member's independent judgment will often require consideration of other personal, professional, commercial, financial and familial relationships, pecuniary and otherwise, that may affect that judgment. Layered on top of this, many issuers have codes of conduct that impose even higher independence standards, requiring directors to avoid relationships or interests that could actually, potentially or reasonably be perceived to undermine their ability to act impartially, objectively and without bias. Boards should consider the full array of circumstances of each director to ensure directors are, and will be perceived to be, independent by the issuers' investors and other stakeholders.

2. Hold regular meetings of independent directors. A public company's independent directors should hold regularly scheduled meetings that non-independent directors and members of management do not attend.

3. Make key board committees entirely independent. As a general rule, all board committees should have at least a majority of independent directors. However, a company's audit, compensation, nominating and governance committees should be composed entirely of independent directors. NP 58-201, NI 52-110 and Glass Lewis all recommend that, subject to certain limited exceptions, these committees be entirely independent. ISS also indicates that those committees should have a majority of independent directors and they should not contain executive directors, controlling shareholders, or non-employee officers of the company or its affiliates that are among the five most highly compensated officers.

4. Limit interlocking director relationships. Boards should seek to minimize their number of "interlocking" director relationships. An interlock occurs when two or more directors also serve as fellow directors of another company. Glass Lewis specifically recommends withholding votes from any directors who have interlocking director relationships with one of the other company executives, whereas CCGG recommends simply limiting the number of director interlocks through formal policies.[114] Consider codifying in the issuer's governance guidelines that there be no more than one board interlock at any given time.

Since a director's independence can change over time, boards should review the proportion of independent directors on an annual basis to ensure that the appropriate minimum thresholds are continuously achieved.

5. Separate the roles of board chair and CEO. Most industry experts and proxy advisory firms, including ISS, Glass Lewis and CCGG, support separating the roles of board chair and CEO. Doing so is important because each role has different responsibilities and objectives. The board chair is responsible for leading the board, evaluating management and company performance, setting executive pay and ensuring that the organizational strategy is in the long-term best interests of the corporation; the CEO, on the other hand, is responsible for leading management, maintaining the day-to-day operations, and developing and implementing an adequate business strategy. Not separating the roles of chair and CEO can obstruct the proper checks and balances on management and may lead to less scrutiny on company performance.

As an alternative, both ISS and Glass Lewis, among others, support the appointment of an independent lead director with a broad range of powers akin to those typically held by the chair, including the authority to call board meetings, to set the agenda for board meetings and to engage with shareholders.[115]

Not separating the roles of chair and CEO can obstruct the proper checks and balances on management and may lead to less scrutiny on company performance.

Diversity on Boards

Diversity initiatives, and specifically those relating to gender, continue to be a hot topic of discussion. Updates to ISS's and Glass Lewis's proxy voting guidelines this past year, together with the announced amendments to the CBCA by the federal government (discussed in Chapter 1, CBCA Reforms: Canadian Government Codifies Corporate Governance Practices) reflect the continued focus on, and evolution of, diversity initiatives relevant to issuers and their boards. For example, whereas previous ISS policy on gender diversity applied solely to Composite Index issuers, ISS expanded its 2019 proxy voting guidelines to apply to all "widely held" companies.[116] ISS will typically recommend withholding votes from the chair of the nominating committee or equivalent if the board has no female members and the company has not disclosed a formal written gender diversity policy.[117] Glass Lewis will generally recommend voting against the chair of the nominating committee if the board has no female members.[118]

A more detailed discussion of issues relating to diversity can be found in Chapter 6, Navigating Gender Diversity in 2019. It is clear today that TSX companies that do not have any female directors or a formal diversity policy are truly the exception to the norm. Diversity will and should continue to play a large role in board composition practices and issuers' overall corporate governance framework.

Board Committees: Building Expertise

While the prevalence of, and the requirements and rules for, certain board committees, (including audit, compensation, nominating and corporate governance committees) are clearly established, we are starting to see companies establish other types of standing board committees, particularly environmental, social and governance (ESG) committees and cybersecurity committees.

ESG is a broad concept covering a wide range of issues, including socially responsible investing, sustainable investing and consideration of general environmental and social factors such as climate change, labour practices, community relations and business ethics. From a governance perspective, cybersecurity relates to the ability of a company to handle the potential negative outcomes associated with cyberattacks, which include attempts to compromise the confidentiality, integrity and availability of computer data or systems.[119]

ESG is a broad concept covering a wide range of issues, including socially responsible investing, sustainable investing and consideration of general environmental and social factors such as climate change, labour practices, community relations and business ethics.

Securities regulators and proxy advisory firms across the world have been focusing on ESG and cybersecurity issues in recent years. Some notable Canadian developments include the following:

- CCGG published *The Directors' E&S Guidebook* (*E&S Guidebook*) in May 2018, providing insights and recommendations for effective board oversight and company disclosure of ESG matters.
- The Ontario Securities Commission (OSC) issued its 2018-2019 statement of priorities, which references a focus on the "growing investor interest in climate change, along with environmental, social and governance (ESG) factors and the need for enhanced ESG disclosure by companies."[120] Although the OSC's 2019-2020 statement of priorities does not prioritize ESG issues, the OSC noted that ESG issues remain relevant and that it would continue to monitor developments and work with the CSA to identify opportunities to improve ESG-related disclosure. Their work culminated in the recent release of CSA Staff Notice 51-358 – *Reporting of Climate Change-related Risks*, discussed further in Chapter 2, Climate Change and Sustainability: New Standards for Sustainability Reporting and Disclosures. The OSC also acknowledged that cyber resilience and data security remain key areas of focus.
- The CSA's 2016-2019 Business Plan identified cybersecurity as a priority area, and the CSA continues to undertake initiatives to integrate cyber-related activities into its work, to better understand the challenges and level of preparedness of companies in respect of cyberattacks and to improve the overall resilience of the capital markets. The CSA has issued several publications regarding cyber risks in recent years, including CSA Staff Notice 11-332 – *Cyber Security*; CSA Staff Notice 11-336 – *Summary of CSA Roundtable on Response to Cyber Security Incidents*; CSA Staff Notice 11-338 – *CSA Market Disruption Coordination Plan*; and CSA

Multilateral Staff Notice 51-347 – *Disclosure of Cyber Security Risks and Incidents* (CSA Staff Notice 51-347). Moving forward, the CSA has indicated that managing cybersecurity remains a key priority.[121]

- Both ISS and Glass Lewis now consider ESG issues in their proxy voting guidelines. Glass Lewis recommends that companies ensure appropriate board oversight of material risks, including ESG issues, to their operations. For large market cap companies and where material oversight issues are identified, Glass Lewis will review the company's governance practices and will disclose instances in which ESG oversight has not been clearly defined. If ESG issues have not been properly addressed by a board, Glass Lewis may consider recommending that shareholders vote against the directors responsible for ESG oversight.[122] Similarly, ISS may recommend voting against the directors responsible for ESG oversight when there are material failures of governance, stewardship, risk oversight or fiduciary responsibilities, including the failure to adequately manage or mitigate ESG risks.[123]

In light of the increased attention on ESG and cybersecurity, companies should consider how best to ensure that there is adequate oversight of these issues at the board level. At a minimum, companies should have some form of oversight framework. Although we are starting to see the more frequent adoption of dedicated ESG and cybersecurity committees, the most effective and adequate framework will vary from company to company, with the board as a whole ultimately being responsible for proper oversight.

CCGG's *E&S Guidebook* recommends that directors consider the nature of ESG issues when selecting the appropriate committee(s) to be accountable for these issues; with some companies requiring dedicated board committees.[124] CCGG's *E&S Guidebook* highlighted one energy company to illustrate the potential comprehensiveness of an oversight framework. For this energy company, the audit committee is responsible for cyber risk; the safety and reliability committee is responsible for operational risks (spills, releases, incidents); and the CSR committee is responsible for stakeholder engagements and climate strategy and reporting. The compensation committee in turn considers how compensation programs affect ESG oversight, and the nominating committee determines the necessary skills required of directors to adequately oversee ESG issues.

From a cybersecurity perspective, several authorities, including the International Organization of Securities Commissions, support the use of dedicated committees.[125] Notwithstanding the foregoing, audit committees are most often identified as being responsible for overseeing cybersecurity risks, with other alternatives being a risk committee, the board and management as a whole, and the chief financial officer or the head of information technology.[126] In any case, boards should ensure the committees responsible for these areas at least have the required skills and expertise to manage their responsibilities.

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Notes

Chapter 5 – In Focus: Building High-Performing Boards

96 *Canada Business Corporations Act*, RSC 1985, c C-44; *Business Corporations Act* (Ontario), RSO 1990, c B.16.

97 Canadian Coalition for Good Governance (CCGG), "Building High Performance Boards" (September 19, 2013), online: https://www.ccgg.ca/wp-content/uploads/2019/03/building_high_performance_boards_august_2013_v12_formatted__sept._19_2013_last_update_-1-1.pdf, at 8.

98 Glass Lewis, *2019 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice (Canada)* (2018), online: https://www.glasslewis.com/wp-content/uploads/2018/10/2019_GUIDELINES_Canada.pdf, at 2.

99 CCGG, "2018 Best Practices for Proxy Circular Disclosure" (2018), online: https://www.ccgg.ca/wp-content/uploads/2019/03/2018_best_practices-ccgg-1-1.pdf, at 17.

100 National Policy 58-201 – *Corporate Governance Guidelines*; CSA Staff Notice 58-306 – *2010 Corporate Governance Disclosure Compliance Review*.

101 Davies, online: https://www.dwpv.com/en/Insights/Publications/2018/Governance-Insights-2018.

102 *Supra* note 98 at 6.

103 *Ibid* at 6-7.

104 Spencer Stuart, "Board Room Best Practice: Lessons Learned from Board Assessments across Europe" (2017), online: https://www.spencerstuart.com/-/media/bbp2017/bbp2017_ipe.

105 ISS, *Canada Proxy Voting Guidelines for TSX-Listed Companies: Benchmark Policy Recommendations* (December 12, 2018), online: https://www.issgovernance.com/file/policy/active/americas/Canada-TSX-Voting-Guidelines.pdf, at 13-14.

106 *Supra* note 98 at 13.

107 ISS, "Director Overboarding: Global Trends, Definitions, and Impact" (July 19, 2019), online at: https://www.issgovernance.com/library/director-overboarding-global-trends-definitions-and-impact/.

108 TSX, *TSX Company Manual,* online: http://tmx.complinet.com/en/tsx_manual.html, section 461.1.

109 *Supra* note 98 at 12 and 15.

110 *Supra* note 105 at 6.

111 For example, see Joann S. Lublin, "Smaller Boards Get Bigger Returns," *The Wall Street Journal* (August 26, 2014), online: https://www.wsj.com/articles/smaller-boards-get-bigger-returns-1409078628.

112 *Supra* note 108 at section 311, footnote 14.

113 "The Globe and Mail's comprehensive ranking of Canada's corporate boards," *The Globe and Mail* (November 25, 2018), online: https://www.theglobeandmail.com/business/careers/management/board-games/article-the-comprehensive-ranking-of-canadas-boards/.

114 *Supra* note 98 at 8 and 14; *supra* note 97 at 7.

115 *Supra* note 98 at 8; *supra* note 105 at 18.

116 *Supra* note 105 at 14.

117 *Ibid*.

118 *Supra* note 98 at 20.

119 The Board of the International Organization of Securities Commissions, "Cyber Security in Securities Markets – An International Perspective: Report on IOSCO's Cyber Risk Coordination Efforts" (April 2016), online: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD528.pdf, at 2.

120 OSC Notice 11-781 – *Notice of Statement of Priorities for Financial Year to End March 31, 2019*, (July 5, 2018), at 1.

121 CSA, "CSA Business Plan | 2016-2019: Achievement Highlights" (2019), online: https://www.securities-administrators.ca/uploadedFiles/General/pdfs/Achievements_CSA_Business_Plan_2016-2019.pdf, at 12.

122 *Supra* note 98 at 15-16.

123 ISS, "International SRI Proxy Voting Guidelines: 2019 Policy Recommendations" (January 28, 2019), online: https://www.issgovernance.com/file/policy/active/specialty/SRI-International-Voting-Guidelines.pdf, at 6.

124 CCGG, *The Directors' E&S Guidebook* (May 2018), online: https://www.ccgg.ca/wp-content/uploads/2019/01/The-directors-ES-Guidebook-1-1-1.pdf, at 14.

125 *Supra* note 119 at 26.

126 CSA Multilateral Staff Notice 51-347 – *Disclosure of Cyber Security Risks and Incidents*, (January 19, 2017), at 2.