Rotman School of Management
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CLARKSON
Centre for Board Effectiveness

Director Accountability Series

Majority Voting in Canada: 2006-2010

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Significant Advances in Canadian Shareholder Democracy

In 2005, the Clarkson Centre for Board Effectiveness (CCBE) began tracking voting processes for director elections among firms listed on the S&P/TSX Composite Index (TSX Index). At that time, only half (52%) of firms allowed shareholders to vote for each individual director's election to the board, while the rest allowed only the election of the entire slate of directors (slate voting). As of the 2010 proxy season, slate voting had become far less common, with only 16% of firms retaining the practice. In fact, of the 45 firms CCBE had observed in the 2011 proxy season as of this writing, only 2 (4%) do not allow voting for each individual director, indicating a further decline in the prevalence of slate voting.

Since 2006, the introduction of majority voting has given shareholders an even more powerful democratic tool, while also increasing director accountability to investors. Prior to 2006, Canadian directors were elected through plurality votes, where ballots contain the option to either vote for or withhold from voting, thus ensuring that every director would be elected as long as they received at least one vote. In recent years, a push toward majority voting – where directors are required to submit their resignation in the event that they do not receive a minimum of 50% of shareholder votes – has been championed by the Canadian Coalition for Good Governance (CCGG), resulting in a significant uptake among large Canadian firms. Between 2006 and 2010, CCBE tracked a steady and substantial year-over-year increase in the number of firms adopting majority voting on the TSX Index (See Figure 1).

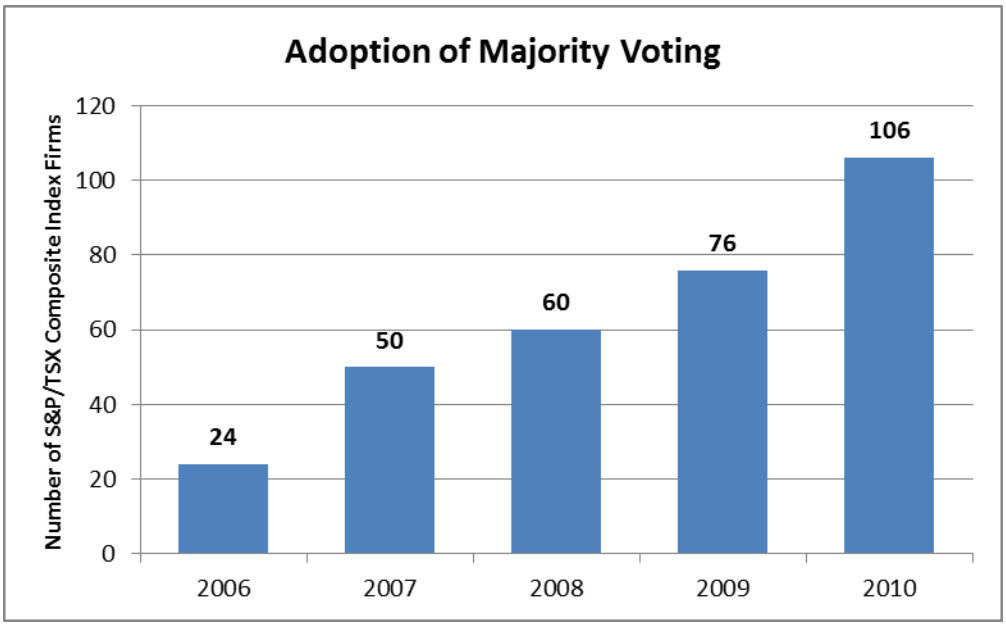

Figure 1 - By 2010, nearly half of the TSX Index had adopted majority voting

Director Turnover and Majority Voting

Since 2002, the average size of TSX Index boards has decreased from 12 to 10.5 directors. As board sizes have decreased, the average proportion of independent directors has risen significantly from 68% to 74% (See Figure 2). Both of these figures are driven by an overall turnover rate – observing both new and departing directors – that has hovered near 20% every year since 2002, with only one exception (See Figure 3).[1] It appears that increasing director independence remains a key priority when seeking new directors.

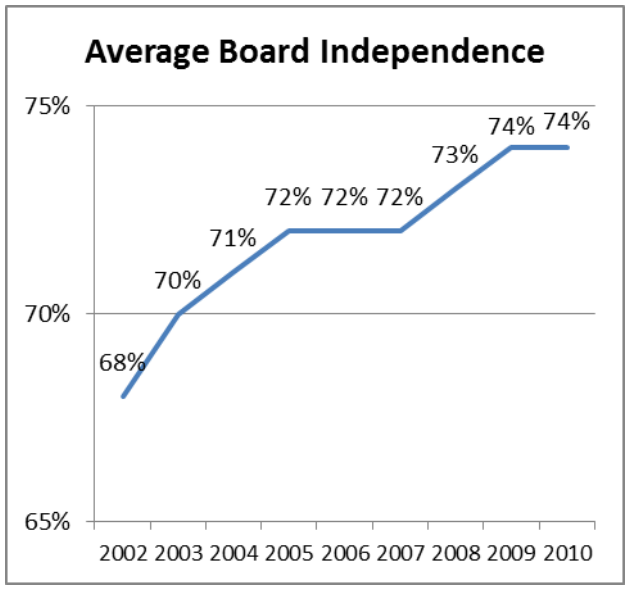

Figure 2 - Director independence has increased steadily since CCBE began monitoring in 2002

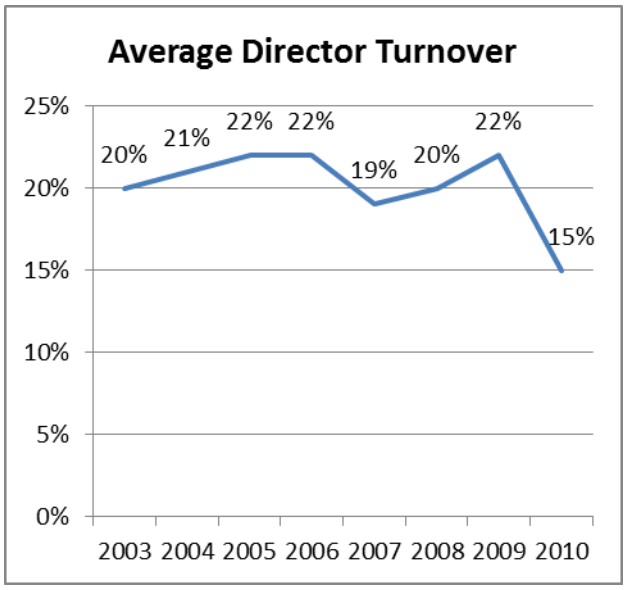

Figure 3 - Except for one anomalous year (2010), director turnover has remained steady since 2002

This steady turnover has not, however, focused on the removal of under-performing directors. A recent CCBE study showed that nearly half of public company directors (46%, or 57 of 123 directors surveyed) are not confident that their boards would dismiss under-performing directors when appropriate. In embarking on this report, CCBE hoped to investigate what effect, if any, the introduction of majority voting has had on director turnover with the ultimate goal of determining whether or not it might assist boards in managing mediocre director performance. Our hypothesis was that boards might demonstrate a higher rate of turnover, or a significant increase in director independence following the adoption of majority voting.

In recent interviews and survey comments, Canadian directors suggested that managing director performance is often, nominally, the Chair's responsibility. Some felt, however, that formal mechanisms

[1] The average director turnover rate on the S&P/TSX Composite Index in 2010 was 15%. This dramatic drop is puzzling. It is unclear whether it is a meaningful occurrence or simply a statistical anomaly. CCBE will be better able to explore this question in 2013 or 2014 when we have several years' worth of subsequent observations.

for director turnover, beyond age and term limits, might help ensure optimal board composition over time – and, ideally, would provide boards with a tool to facilitate the removal of ineffective directors. Generally, these directors were unable to clarify what such a process might entail. Complicating matters, any valuable director turnover mechanism must, in addition to achieving board renewal objectives, ensure that the board is able to attract and retain highly effective new directors.

Majority voting is a tool wielded by shareholders rather than boards, and as such may not easily achieve directors' goals as described above. It is, however, a mechanism that encourages board-shareholder engagement on the topic of director effectiveness and board composition, similar to what *Say on Pay* is currently achieving with respect to compensation. In 2010 and 2011, the lowest shareholder support for an individual director's election among TSX Index firms was 54%; an outcome observed in only one case, and on a board that has not adopted majority voting. In other words, not one director has been voted off of a board. In 2009, Ontario Teachers' Pension Plan very publicly voted against the election of each member of the Bank of Montreal Compensation Committee due to a misalignment between CEO pay and performance. Nonetheless, every committee member received at least 87% shareholder support for his/her election to the board. As such, majority voting seems generally to be used by shareholders as a political, rather than practical, tool allowing them to express their views on board decisions and outcomes, knowing that it is unlikely to cause governance upheaval for any particular board except in very exceptional cases.

What about boards' desire for formal practices to help manage poor director performance? CCBE examined board turnover patterns on the TSX Index from 2002 to 2010 with the goal of determining what, if any, impact the adoption of majority voting has had. In 2006, the year that TSX Index firms started adopting majority voting, the 24 earliest adopters of the practice had director turnover rates (23%) roughly the same as the TSX Index average (22%). In 2007, however, the 50 firms that had adopted majority voting had notably lower director turnover rates (16%) than the rest of the TSX Index (20%). Board turnover has remained lower for firms with majority voting ever since.

Does this mean that majority voting has directly lowered board turnover rates? Throughout most of our observation period, board turnover rates are notably higher among boards that *eventually* adopted majority voting than those who have *already* implemented majority voting. This was true in every year in our sample except for 2006 – the first year majority voting appeared among TSX Index firms – and especially true in 2007 (See Figure 4 below). One possible explanation is that these boards made adjustments to their composition to ensure shareholder satisfaction when majority voting was eventually in place. Once the boards' makeup was optimized, the desire for director turnover decreased, thus possibly explaining the lower turnover rates among firms who have already adopted majority voting. In this sense, it may have been the *anticipation* of majority voting rather than the process itself that impacted the rate of director turnover.

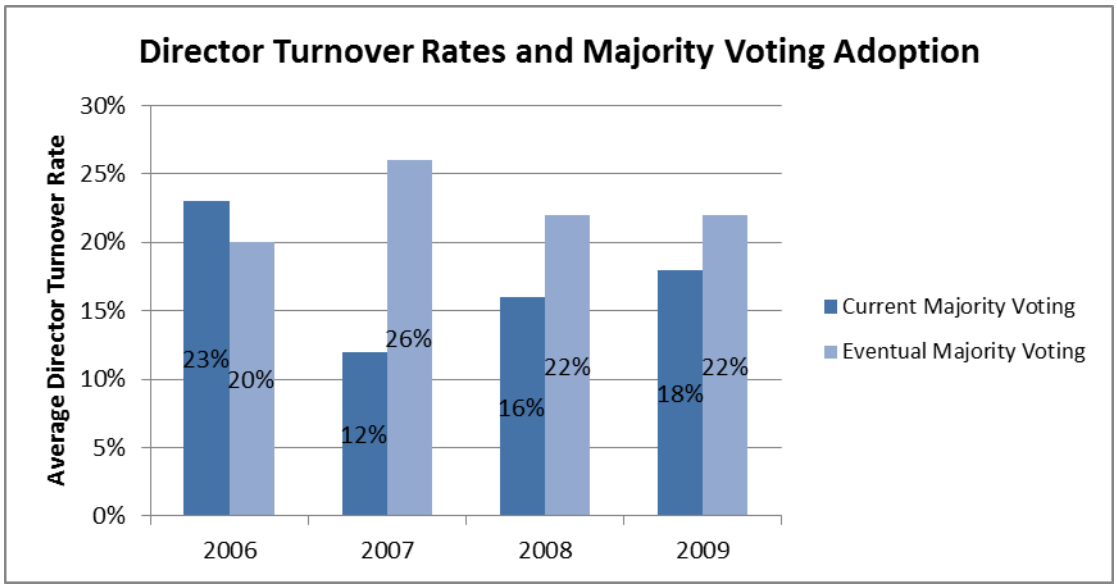

Figure 4 - Following the initial appearance of majority voting on the TSX Index in 2006, many boards undertook significant director renewal in advance of their implementation of majority voting

CCBE will monitor this trend in upcoming years. In light of the significant overall decrease in director turnover in 2010 as noted above, it is likely that we will see similar changes in the gap between firms with and without majority voting. In addition, this gap has become smaller in each year since it was first observed in 2007. This may indicate that most of the boards in need of significant renewal adopted majority voting quickly in order to expedite the turnover process. CCBE will revisit these trends in upcoming years when more data is available.

Majority Voting and Director Independence

CCBE also found that firms with majority voting have a significantly higher proportion of independent directors than those without (See Figure 5 below). This seems to support the above theory that boards undertake aggressive board renewal in advance of adopting majority voting. CCBE's investor stakeholders have long agreed that director independence is an important element to managing conflicts of interest and improving decision making in the boardroom. It appears that boards have prioritized increasing independence when preparing for majority voting, perhaps for the very reason that it is important to investors.

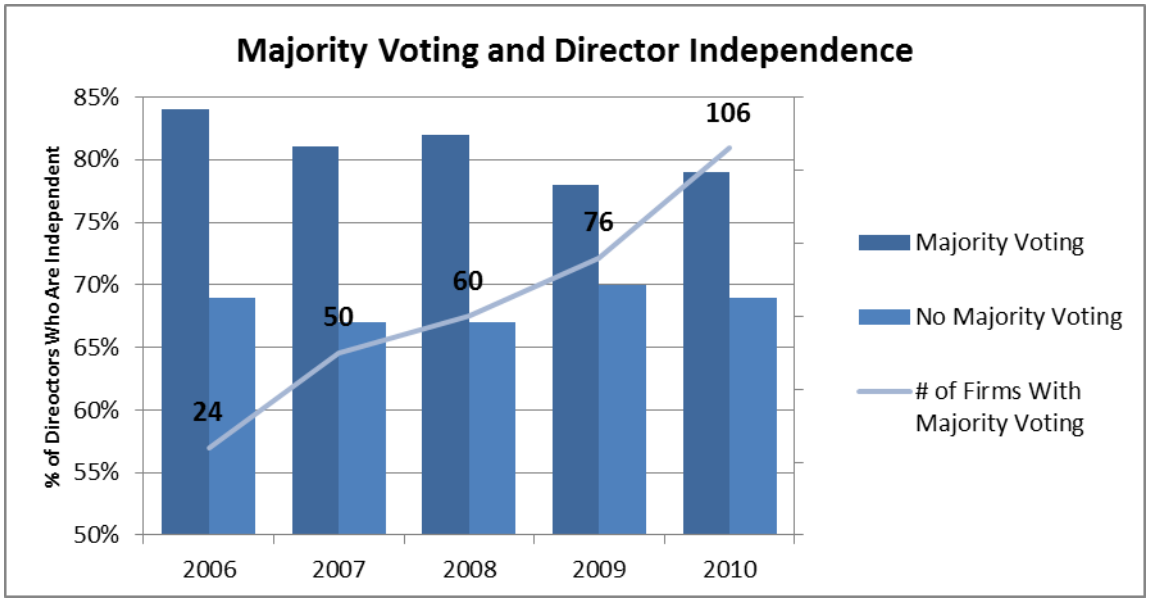

Figure 5 - Firms with majority voting have significantly higher director independence than their counterparts

Conclusions

Since its first appearance in 2006, majority voting has now been adopted by nearly half of all firms listed on the TSX Index. Boards have prepared themselves for the resulting shareholder influence on director elections by undergoing significant renewal and increasing overall board independence. By the time firms implement majority voting, director turnover typically slows down because important adjustments have already been made.

In upcoming years, CCBE will continue to monitor these trends. By the time majority voting has been in place for 8-10 years, its impact on board makeup, as well as on other governance behaviour, will be clearer. We will also at that time be able to observe meaningful relationships between shareholder democracy vehicles (majority voting and individual director elections) and voting outcomes over a meaningful timeline. This will allow us to identify what, if any, circumstances are most likely to result in lower support for a director's election.

CCBE recognizes the generous support of the Ontario Teachers' Pension Plan and the Canadian Coalition for Good Governance in our ongoing governance research initiatives.