

Canada Deposit Insurance Corporation

Operation of SOE Boards: Composition and Nomination of Boards

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**Chairman of the Board
Canada Deposit Insurance Corporation**

**Prepared for the
2005 Policy Dialogue on Corporate Governance in China**

**Beijing, China
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First, I would like to say thank you for having been invited to participate in this conference. It is an honour to be able to do so and a pleasure to be in Beijing for it.

I also want to express appreciation of the work done, and being done, by the OECD in providing the Guidelines on Corporate Governance of State-Owned Enterprises and the Comparative Report. The Guidelines provide a most helpful compendium of principles and practices against which to compare one's own country's performance and identify areas in which improvements might be made. The Comparative Report illustrates how many experiences and problems different countries have in common, which suggests the usefulness of sharing experiences and problems and how they have been, or should be, dealt with.

In Canada, state-owned enterprises usually are called "Crown corporations". Similar to the description in the OECD Guidelines, Crown corporations are entities with a legally distinct form separate from the administration of the government. In Canada, they are corporations and their governance structure is essentially the same as a private sector corporation with a Board, led by a Chair, and management, led by a CEO. Not all federal Crown corporations have commercial activities. But all federal Crown corporations do pursue public policy aims. The Treasury Board of Canada Secretariat ("TBS" or "Treasury Board"), Canada's federal public-sector management agency, describes Crown corporations as deriving "their raison d'être from their statutory role as instruments of public policy" (TBS, 2005, p. 9).

In all, there are currently 43 federal parent Crown corporations in Canada and three subsidiaries of Crown corporations that are required to report on their operations as though they were parent Crown corporations. Other Crown corporations exist in Canada and operate at provincial levels. In addition, our governments have created other entities which in some respects could be considered to be state-owned enterprises, but which are not Crown corporations. The governance regimes for provincial Crown corporations and those other

entities vary in different ways from the regime for federal Crown corporations. To avoid confusion, I will confine my remarks to federal Crown corporations as they are the main focus of attention in Canada these days. For the sake of compatibility with the Guidelines, I will call our federal Crown corporations “federal state-owned enterprises” or “SOEs”, although, as mentioned they are not the only entities which could fall within the definition in the Guidelines.

Given that each of the 46 federal state-owned enterprises plays a different role in the economy, was created to fulfil a different public policy objective, and has different day-to-day operations, it would be exceedingly difficult—if not impossible—to devise a “one-size-fits-all” regime for their governance.

However, as is the case with the OECD Guidelines, our federal Government recognizes that there are basic principles of general application which ought to be followed with respect to all, or almost all, federal state-owned enterprises. That is particularly so in the case of the composition and nomination of Boards.

Accordingly, our federal Government has committed to improve the governance of its state-owned enterprises as a whole through a series of measures laid out by our Treasury Board Secretariat in a recent document entitled “Review of the Governance Framework for Canada’s Crown Corporations” Report to Parliament, (the “TBS Report”).

The Conceptual Framework

In Canada, federal SOE are wholly owned by the Government of Canada. Each federal state-owned enterprise in Canada therefore reports to Parliament through a responsible Minister. The conceptual framework is that the Government derives its authority from Parliament. Accordingly, in accordance with parliamentary tradition and practice, a Minister of the government has to be accountable to Parliament for the effectiveness of any SOE which comes within the Minister’s portfolio. However, as the purpose of having certain activities conducted by a separate entity, rather than by a government department, includes giving that entity autonomy in how it conducts its operations, the relevant Minister is answerable, rather than accountable, to Parliament for the corporation’s activities, particularly those pertaining to its day-to-day operations. In other words, while the responsible Minister is accountable – that is responsible – for the overall performance of the Crown corporations within his or her portfolio, he or she is only answerable – but not responsible – in Parliament for its day-to-day operations. The Minister is not charged with directing the affairs of an SOE, and accordingly is not accountable for them. That accountability falls to the SOE’s board of directors.

The Treasury Board explains the difference between accountability and answerability as follows:

Accountability is the means of enforcing or explaining responsibility. It involves rendering of account of how responsibilities have been carried out. It also includes taking any necessary corrective action if things go wrong and explaining how problems have been or will be corrected. Depending on the circumstances, it may entail accepting personal consequences for problems that the office holder caused or that could have been avoided or corrected if the office holder had acted properly.

Answerability is the duty to inform and explain but does not entail the personal consequences associated with accountability.

Let me explain it this way, as it is significant as emphasizing the autonomy of Crown corporations. If some egregious wrongdoing occurs in a Minister's department, the Minister may be called upon to resign even though it is his officials who failed to prevent the wrongdoing, as he is responsible for their failures. If the same sort of wrongdoing occurs in a Crown corporation, because it is autonomous the Minister will not be called upon to resign, instead it likely will be the Chair or the CEO whose resignation is asked for.

The logic of this model therefore leads to focusing on the Board as the body responsible for the management of the SOE. As the Government owns the SOE, it has an owner's responsibility to appoint an appropriate chair of the Board and appropriate directors. They are the people accountable to the Minister, and through the Minister to Parliament. Logically, if the Board has that accountability it should be primarily entitled, and responsible, for the appointment of the CEO of the SOE because the CEO is accountable to the Board. In Canada, the Minister still has the final decision on the appointment of the CEO, but as I point out later, that power of decision is now effectively limited because of the enhanced role of the board. In addition, if the Board is accountable as I have said, it should have a role regarding the Board's composition. An effective Board should have members whose skills complement each other and enable it to fulfil its role, or roles.

As you can see, this conceptual model is quite compatible with the Guidelines and logically leads to other results as advocated in the Guidelines, such as separation of chair and CEO roles, management having little, if any, role in the composition of the Board, and so on. The problem is ensuring that actual practice conforms. That is the problem which the TBS Report which I mentioned addresses.

Problems in Practice

The TBS Report concludes that a number of changes need to be made to the way in which federal SOEs have been handled in practice. The Report does not

recommend any major changes to the conceptual framework, rather its focus is on how to make clear what the framework entails and how to make it effective. As stated in the Report, there has been a lack of clarity and some confusion in the minds of some of those involved in how the system should work.

The Report's main findings include that the accountability regimes have to be clarified and strengthened, as do the stewardship roles of Boards, that the appointment process has to be improved, that directors have to be better equipped to fulfil their responsibilities and there needs to be more transparency in the activities and operations of the federal SOEs. (You might almost think that the authors of the Guidelines had a hand in writing the Treasury Board Report!)

Ministerial Responsibility

Some of the problems which have arisen include first, lack of clarity over who in government represents the government as owner – now which will be clearly stated to be the relevant Minister, and not the public servants in his or her ministry or others; second, how government policy objectives and priorities are communicated – now to be reinforced by a periodic statement from the Minister; and third, just what responsibilities directors have – now to be embodied in further legislation and in written guidance from the Minister regarding the Government's expectations on how they fulfil their role.

Appointment Process

The Board Members of SOE boards are appointed by the government of the day. They are appointed for fixed terms, are required by law to uphold their fiduciary responsibilities to the corporation, and are expected to ensure that the corporation performs its mandate (and does not stray from it) and is well managed.

Unfortunately, in some recent cases in Canada, a very few but highly publicized number of SOEs are alleged to have engaged in some inappropriate activities. At least some of those involved had past connections with the governing political party, i.e. are alleged to have been patronage appointments, and to have used their positions in inappropriate ways.

Chairs and Directors

To deal with this situation, just as the Guidelines recommend that there should be a "well structured and transparent board nomination process", the TBS Report calls for a more formal process in the appointment of chairs and directors of Boards. For example, Boards are required to provide selection criteria to the Government for Chairs of Boards and competency profiles for Boards as a

whole, and to outline the needs the Board may have regarding the skills and experience of its members. These selection criteria and competency profiles are to be made public. Vacancies will be publicized, including having the Government develop a central website for recruiting qualified candidates.

Consistent with the Government's role as owner, it will continue to make the final decision on these appointments. However, as a further check on who is appointed, the Government has committed to working out a process for parliamentary review of proposed appointees.

CEOs

In the past, appointments of CEOs have come about in various ways. Most have been appointed by the Government rather than the Board, in some cases with prior consultation with the Chair, in others with consultation with the whole Board, but in still others with no, or no real, consultation with either the Chair or the Board. The latter scenarios are what are perceived to have given rise to problems and allegations of patronage.

The OECD Comparative Report which accompanied the Guidelines, at page 97, sets out the Canadian Auditor General's summary of three models of selecting CEOs. I can now update the Report. Our Treasury Board has firmly opted for the so called "Board search model", which, as the Report states, should lead to more accountability and enhanced mutual trust and respect.

Canada Deposit Insurance Corporation ("CDIC") has just gone through the new process for the CEO search and it has worked very well, so let me describe what we did.

Our CEO had announced some months in advance that he planned to retire on April 1, 2005. Although the TBS Report had not come out, the CDIC Board decided that it wanted to take charge of the replacement process. The Board created a Nominating Committee from its membership with a majority of private sector directors, and retained a professional search firm. I, who also comes from the private sector and has never been a Government employee, acted as Chair of the Committee. With the assistance of that firm, the Nominating Committee prepared a job description, an accountability profile and selection criteria. The vacancy was then advertised, the search firm sought out possible candidates and the Minister and others were invited to provide suggestions.

That process led to 27 applications to sort through. The search firm did an initial search and then consulted me as Chair about the balance of the applicants. That led to a further reduction in the number of applicants thought to be worth further consideration, and that process and the resumes were reviewed by the whole Nominating Committee. Following that, there was an initial round of interviews of candidates by the Nominating Committee, which led

to it coming down to two of three candidates to be interviewed yet again. Other Board members were invited to attend these last interviews if they wished. The Nominating Committee then reported to the full Board, which accepted the recommendations of the Nominating Committee and put them forward to the Minister together with appropriate information regarding the process, the candidates and the results.

The Minister, after making such enquiries as he wanted, accepted the recommendation and obtained the approval of the Government. It so happened that as all of this was going on it became known what the Treasury Board was going to recommend as the new process and we made certain that what we were doing conformed to it. The final stage was then for the proposed candidate to appear before the appropriate Parliamentary Committee. That Committee unanimously endorsed our choice – largely due to the quality of the candidate, but also, I think, helped by the thoroughness of the process followed. That process was time consuming and cost CDIC money but it was well worth the effort. And we are very pleased with the result, as are our employees. Clearly, there was not even a vestige of favouritism or patronage involved.

And that is how, I think, the new process for appointing CEOs is likely to work for most SOEs in Canada. This process does not go as far as the Guidelines in having the appointment of the CEO actually made by the Board. However even though the appointment ultimately will still be made by the Government, if a Board takes up the opportunity of controlling the process and does it well, it would seem most unlikely that the Government will not accept the result.

Composition of the Board

The basic issues regarding Board composition of SEOs obviously are much the same as with private sector corporations – having people with good judgement, appropriate experience, required skills, high ethics and so on who are prepared to take the time and make the effort required to perform their role.

However, as stated in the Guidelines, there are certain qualities which require emphasis in the case of an SOE, and this is well recognized in Canada. Because of their very nature and because of who appoints directors, it is most important that all directors be able to be objective, independent and free of political influence.

The problems raised in the Guidelines regarding having Government employees on SEO Boards are perceived to have been a problem in Canada, although not in CDIC's case even though we have an unusually large number of them. The problems include that, notwithstanding and in part as a result of the knowledge and expertise which such employees bring to the Board and the benefit thereof to the Board, such employees may have, or be seen to have, undue influence at the Board. Also, such employees, who have duties of loyalty in their primary

position, may have difficulty reconciling those loyalties with their duty of loyalty to the SOE or may be thought not to exercise independent judgement. In Canada, their fiduciary duties are exactly the same as other directors. But how do they handle, for example, a situation where their duties conflict. The response to these problems in the TBS Report is to make it clear that the Government is committed to the principle of ensuring Board independence and so will restrict or eliminate public servants participation on SOE Boards.

This could have a significant impact on my Board at CDIC, as our members include the Governor of the Bank of Canada, the Deputy Minister of Finance, the Superintendent of Financial Institutions and the Commissioner of the Financial Consumer Agency of Canada, a very potent collection of Government sector directors. That is because CDIC is an integral part of the financial safety net in Canada and is the one which has to handle whatever may be the ultimate solution for a failing deposit taking financial institution. Those directors just mentioned, of course, also represent participants in the financial safety net so there are logical reasons for having them on the Board. CDIC does not report to any of them, rather it reports to the Minister of Finance himself. I need not pursue whether or not, in the case of CDIC, we should cease to have any Government employee directors, however our situation illustrates why “one size” may not fit all. I have such strongly minded independent private sector directors on my Board that undue deference to the officials is not a problem, and so far we have dealt with the divided loyalties issue successfully on a pragmatic basis.

I think I have said enough to illustrate the degree to which, in Canada, we have had, and have dealt with issues identified in the Guidelines. The Canadian perspective is very much the same as that expressed in the Guidelines regarding these issues. I could go on with various of the other issues raised in the Guidelines not only with regard to Board nominations and composition but also with regard to other important matters, such as transparency, reporting, stakeholder relations, codes of conduct, etc. With all of these the Canadian perspective is in all essentials compatible with the Guidelines. We have gone through the same learning process and ended up pretty much at the same place.

Overall, I think our system has worked well, albeit with the occasional, but rare, problem. With the changes described, the system should work even better.

Thank you for your attention.