PACICC

Strategy for Corporate Governance Reform at PACICC

Options and Recommendations

April 2004

Introduction

During the first half of 2003, the Property and Casualty Insurance Compensation Corporation (PACICC) initiated a consultation process with member companies to ensure a continuing strong and effective capacity to respond to future P&C insurance company insolvencies.

The consultation process resulted in broad agreement among member companies that PACICC should focus on organizational change involving three key areas:

1. Proactive operations
2. Effective governance
3. Relevant research.

On November 18, 2003, PACICC's Board of Directors met to finalize a strategic plan and budget addressing these three key result areas for the period 2004 to 2006. One of the near-term deliverables promised in the new strategic plan was that PACICC's management would prepare and submit to the Board in May 2004 a detailed strategy for corporate governance reform. That strategy is outlined in this paper.

PACICC's strategic plan for 2004-06 describes the goal of effective governance in the following terms:

> *Revitalize the mission and principles of PACICC to ensure effective governance of the organization and strong performance in meeting the expectations of member insurers, insurance consumers and insurance regulators.*

This is a substantial undertaking. Creating a comprehensive reform plan requires a close examination of the key corporate governance issues affecting PACICC's performance, taking into account stakeholder expectations and best practices as part of the effort to develop appropriate options and recommendations.

The governance reform framework outlined for PACICC in this paper addresses the following key issues:

- Corporate mission statement
- Director duties and responsibilities
- Board role in management supervision and strategic planning
- Committees of the Board
- Board size
- Board composition and independence of directors
- Compensation of directors
- Length of service for directors
- Frequency of Board meetings
- Director training and education
- Evaluating the Board's performance.

This paper was prepared by Paul Kovacs and Jim Harries. We gratefully acknowledge the many helpful comments and advice provided by Alex Kennedy and Randy Bundus. In developing the options and recommendations in this paper, PACICC management consulted a wide range of information sources dealing with stakeholder expectations and best practices in corporate governance. These information sources included guidelines and publications issued by the Office of the Superintendent of Financial Institutions (OSFI), the TSX, the Institute of Corporate Directors, and the National Association of Corporate Directors, among others. All of the key information sources that were consulted are listed at the end of this paper.

PACICC's corporate governance environment

PACICC has a unique corporate governance environment. On the one hand, it is a not-for-profit organization. As a result, some of the shareholder-protection issues currently influencing corporate governance practices may not apply directly to PACICC. On the other hand, PACICC is not a typical not-for-profit organization. Membership in PACICC is not voluntary but is required by law. As well, PACICC does not engage in fundraising or philanthropy like most not-for-profits. In fact, PACICC has significant financial responsibilities to its two main stakeholder groups – insurance consumers and member P&C insurers. Both of these groups have a substantial interest in how PACICC is governed and managed.

Before reviewing specific governance reform issues, it is useful to consider the interests of PACICC's two main stakeholder groups and the benefits that each derives from corporation's success:

- **Insurance consumers** – the policyholders who rely on PACICC for *payment* of claims and unearned premiums in the unlikely event of an insolvency

- **Member P&C insurers** – the companies who *fund* PACICC and benefit from the claims payment guarantee it provides to their customers.

While insurance regulators do not have the same direct financial stake in PACICC's activities as insurance consumers and member P&C insurers, they do have significant input into how the Corporation is governed and managed, including the power to approve or disapprove any amendment to PACICC's by-laws. In addition, PACICC's involvement as an inspector in specific insolvencies – working directly with liquidators to manage the process – permits insurance regulators to focus their resources on minimizing the risk of insolvency and on other consumer protection responsibilities.

Because PACICC's corporate governance environment is unique, no single set of best-practice guidelines (such as those issued by OSFI or the TSX) is likely to meet the expectations of stakeholders with respect to good governance. This is especially true considering that many elements of these best-practice guidelines have been developed with widely held public companies in mind – primarily to protect the interests of shareholders.

PACICC's challenge in reforming its corporate governance is to adopt those aspects of current best practices that apply to its unique environment, while ensuring that the needs and interests of its main stakeholder groups are appropriately represented in a fair and balanced manner.

Corporate governance reform issues

1. Corporate mission statement

Issue – Although PACICC has clear objectives, the Corporation does not have a comprehensive philosophy and mission statement. PACICC has not yet fully developed its operational principles and its organizational goals.

Findings – The task of approving a corporate philosophy and mission statement is generally viewed by experts on corporate governance as a responsibility of the board of directors. PACICC's current mandate is stated in Article III of its Letters Patent, but this is mainly a statement of the corporation's purpose. PACICC does not have a clear statement of its mission – one that captures its philosophy as an organization, especially the mandate that was clarified by the recent member consultation process and formally approved by the Board in the November 2003 PACICC Plan and Budget.

What are the main benefits of having a corporate mission statement? The American Society of Corporate Secretaries gives a convincing explanation:

> "A mission statement is not a legal document, but it may be the most important of your organization's governing documents. It defines your goals and directs your future. It helps your management, board and volunteers to focus on your stated goals and helps to educate others about your organization. The process of developing or updating your mission statement can be time-consuming, but it will help focus your organization's energies on what is really important."

For PACICC, in particular, a mission statement would have two important benefits:

1. it would help clarify the organization's purpose and priorities in the minds of stakeholders (insurance consumers, member insurers and regulators)
2. it would help the Board and management stay focused on the key result areas – proactive operations, effective governance and relevant research – set out in the strategic plan.

What have similar organizations adopted as mission statements? Below are three examples from insurance compensation and regulatory organizations that are well known to PACICC.

> **CompCorp**
> "CompCorp's mission is to mitigate the impact on Canadian policyholders of the financial failure of a life insurance company. We work in partnership with regulators on any necessary interventions, seeking to both minimize long-term costs and preserve consumer perceptions of industry strength."

Texas Property and Casualty Insurance Guaranty Association
"The mission of the TPCIGA, as a partner in the insolvency process, is to promptly and fairly pay covered claims, minimize financial loss, and provide a full range of services to our customers."

OSFI
"The Office of the Superintendent of Financial Institutions Canada is the primary regulator of federally chartered financial institutions and federally administered pension plans. OSFI's mission is to safeguard policyholders, depositors and pension plan members from undue loss. OSFI supervises and regulates all banks, all federally incorporated or registered trust and loan companies, insurance companies, cooperative credit associations, fraternal benefit societies and pension plans."

Based on the general approach taken by the organizations above, a starting point for a new mission statement for PACICC could be as follows:

PACICC Mission (Draft)
The mission of the Property and Casualty Insurance Compensation Corporation is to protect eligible Canadian policyholders from undue financial loss in the event that a member insurer becomes insolvent. We work to minimize the costs of insurer insolvencies and seek to maintain a high level of consumer and business confidence in Canada's property and casualty insurance industry through the financial protection we provide to policyholders.

The core business of PACICC is to protect the financial interests of insurance policyholders if a member property and casualty insurance company becomes insolvent. To manage its business effectively, PACICC will adhere to the following principles:

PACICC Principles (Draft)

- *In the unlikely event that an insurance company becomes insolvent, policyholders should be protected from undue financial loss through prompt payment of covered claims*
- *Financial preparedness is fundamental to PACICC's successful management support of insurance company liquidations, requiring both adequate financial capacity and prudently managed compensation funds*
- *Good corporate governance, well-informed stakeholders and cost-effective delivery of member services are foundations for success*
- *Frequent and open consultations with members, regulators, liquidators and other stakeholders will strengthen PACICC's performance*
- *In-depth P&C insurance industry knowledge – based on applied research and analysis – is essential for effective monitoring of insolvency risk.*

A list of performance-related goals appears at the end of this paper (on page 21).

Recommendation – The PACICC Board should establish a mission statement for the corporation (including principles and goals) as a key governing and public document. To ensure that a new PACICC mission statement represents the corporation's constituency, the process of developing it should allow for broad stakeholder input. Once approved, the mission statement should be featured prominently in PACICC's communications with stakeholders and the general public – including on the corporation's web site and in the annual report issued by the Board of Directors. The mission statement should also be added to PACICC's memorandum of operations.

2. Director duties and responsibilities

Issue – PACICC should establish a policy that defines and documents the key duties and responsibilities of its Directors.

Findings – Every corporate director has two basic duties to the corporation they serve – a fiduciary duty and a duty of care. Fiduciary duty means that a director will act honestly and in good faith with a view to the best interests of the corporation. The duty of care requires every director to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. While these basic concepts are understood by law to apply to all directors, it is considered good practice for a corporation to document its own specific understanding of what these duties and responsibilities mean in practice. Such documentation would cover related issues like conflict of interest, related-party dealings, when to abstain from voting, confidentiality, the duty to disclose, and so forth.

PACICC currently produces a memorandum on Directors' duties that is sent to all Board members annually (the document is prepared by Torys LLP, PACICC's external legal counsel). While the memorandum summarizes legal obligations, good practice (according to Industry Canada and the Canadian Society of Association Executives) suggests that all directors should receive a comprehensive Board manual containing the following information elements:

- names of Board members, their biographies, terms of office and a statement of their responsibilities
- a list of committees and task forces, with their terms of reference, time frames and membership
- a brief written history of the corporation and/or a fact sheet about the corporation
- Letters Patent, supplementary Letters Patent and by-laws
- mission and vision statements
- strategic framework or plan, and the current annual operating plan
- minutes from recent Board meetings
- Board policies (for example, conflict of interest, insurance coverage, expense reimbursement)
- the prior year's annual report and audit report
- current annual budget and latest financial statement
- banking resolutions and investment policy
- current list of major funders or partners and/or stakeholder map
- organization chart and staff information
- annual calendar
- promotional material and web site information.

Recommendation – PACICC should complete, as soon as possible, work that has been initiated on a comprehensive Board manual. The content should be similar to that recommended by Industry Canada and the CSAE (see list above). The current memorandum on Directors' duties would also form part of the manual.

3. Board role in management supervision and strategic planning

Issue – What is the appropriate role for the Board of Directors in supervising management? How involved should the Board be in the corporation's strategic planning process?

Findings – Experts agree that effective corporate governance requires a board of directors to supervise and monitor management in relation to agreed-upon objectives, rather than actively participating in the day-to-day management of a business. In practice, the appropriate balance is not always clear or easy to achieve. In an article written for the Institute of Corporate Directors, John Carver states:

> "The central dilemma in governance, as in management, is how to control without meddling, how to get one's arms around the organization without one's fingers in it."

Activities typically covered by board supervision of management tend to include strategic planning, financial reporting, capitalization, and evaluating the performance and determining the compensation of senior management.

In the past, PACICC's Board has tended to be more involved in managing the corporation's business, in addition to governing effectively (as defined by the various guidelines discussed in this paper). However, there were reasons why this balance was struck – including a lack of management resources and the absence of a strategic plan. This has now been addressed in a restructured organization that will be guided by a Board-approved strategic plan and managed by a professional staff with adequate resources. A key challenge for PACICC's Board of Directors going forward will be to establish the right framework for supervising and monitoring the performance of management in achieving the corporation's strategic objectives. How should this be done?

Active involvement in PACICC's strategic planning process is the best way for the Board to focus on the essential task of advising, supervising and monitoring management. The Conference Board offers the following advice:

> "An effective board plays an integral role in the strategic planning process. Management develops the strategic plan, while the board reviews and approves it. Directors require a host of both internally-produced and externally-gathered information to effectively review and evaluate strategy. Sufficient board time should be devoted to discussing the strategic plan – openly and regularly with the CEO in executive board sessions – so that all board members understand it well enough to track its progress in an informed manner. In addition, the board should spend one "retreat" session per year on strategic oversight."

If this can be taken as a statement of good practice, then PACICC's Board has already made significant progress in this direction by reviewing and approving a new three-year strategic plan for the corporation, initially for the period 2004 to 2006. The challenge will be to ensure that management is both well advised and supervised by the Board in carrying out the strategic objectives that have been approved for PACICC.

Recommendation – The PACICC Board should play an active role in the corporation's strategic planning process. This should involve more than simply reviewing and approving the strategic plan. For example, it would be considered good practice for the PACICC Board to hold a strategy session at least once a year (this would be the core activity at the Fall Board meeting). By playing a substantive role in the strategic planning process, the Board can then appropriately delegate to management the day-to-day business of running PACICC while still having the control it needs to govern the corporation effectively.

4. Committees of the Board

Issue – What Board committees are considered essential for effective corporate governance? What committees should PACICC have as part of its governance structure?

Findings – PACICC has three "standing" Board Committees – an executive committee, an audit committee, and an investment monitoring committee. These particular committees are not formally required by the Corporation's by-laws. In addition, the power exists to create "advisory committees," for example, for the purpose of dealing with PACICC's obligations when insurer insolvencies occur.

The audit committee should be retained. It is a legal requirement for public companies, and both the TSX and OSFI discuss the role of the audit committee in some detail in their respective corporate governance guidelines. The best practice recommendation from the TSX and OSFI is that the audit committee should not include any management staff (accordingly, management staff are not permitted to be members of PACICC's Audit Committee). In PACICC's case, consideration should be given to expanding the responsibilities of the audit committee to include risk management and contingency planning.

PACICC's investment monitoring committee has an important function in managing the $34 million Compensation Fund that serves as a contingency reserve for future insolvencies. The Board recently expanded the Committee's responsibility to include monitoring the corporation's other investments, including PACICC's liquidation funds.

The evidence reviewed suggests that executive committees are becoming less common, especially with smaller boards. The role of PACICC's Executive Committee could be clarified – for example, to focus on matters of corporate policy, governance and human resources. Indeed, the Board should consider renaming the Executive Committee as the Governance and Human Resources Committee.

Recommendation – PACICC's current Board committee structure is largely appropriate and consistent with effective corporate governance. To clarify its role, PACICC's Executive Committee should be renamed as the Governance and Human Resources Committee. Consideration should be given to clarifying and documenting the responsibilities of each standing committee. This would include a statement of responsibilities and expectations, identification of staff leadership, establishing regular meetings, evaluation of performance, and regular reporting of activities to the Board.

5. Board size

Issue – How many Directors should PACICC have? What is the optimal size of the Board?

Findings – PACICC currently has 15 members on its Board of Directors (it has been agreed that the number will temporarily decline to 14 following the May 2004 annual general meeting). The corporation's by-laws state that "the number of directors to be elected at any annual general meeting may be fixed by resolution of the board of directors prior to the meeting provided that the number so fixed shall not be less than 5 nor greater than 15." The by-laws also state that "the board of directors shall… ensure that its nominees adequately represent all participating jurisdictions." In practice, PACICC works to ensure that different sizes and types of P&C insurance companies are represented on the Board (for example, large and small companies, direct writers and companies who distribute their products through brokers, national and regional companies, and so forth). In addition, by requiring that any member company director be a "senior official" of the company they represent, PACICC ensures that a high level of P&C industry knowledge will be present on the Board.

Recent survey evidence shows that the average size for corporate boards is considerably smaller than PACICC's. For example, the survey of corporate board governance in Canada published by Korn Ferry International in 2002 indicated an average board size of 10 members. The same study also showed that approximately half of the 300 largest corporations in Canada have boards ranging in size from six to nine members. A survey conducted in 2001 by the National Association of Corporate Directors (NACD) revealed similar information – 89 percent of companies surveyed had 11 or fewer board members. Only 1 percent had more than 15 board members. The NACD concludes that the "ideal board size" is between 8 and 11 members.

Corporate governance guidelines issued by the TSX also address the subject of board size, in Section 474 (7) of the TSX Company Manual, stating:

> "Every board of directors should examine its size and, with a view to determining the impact of the number upon effectiveness, undertake where appropriate, a program to reduce the number of directors to a number which facilitates more effective decision-making."

Carol Hansell (*What Directors Need to Know*, 2003) states:

> "The challenge is for the board to be large enough to have the right balance of skills and experience represented, but not so large that it becomes difficult for each director to contribute effectively."

Finally, William Dimma (Institute for Corporate Directors) offers an interesting perspective on the relationship between board size and reliance on committees. He says that with larger corporate boards:

> "…the locus of decision shifts from the full board to an executive committee, along with a generous assortment of functional committees. As corporate boards have grown smaller, executive committees have become less common. In the corporate world, they are, in fact, an endangered species."

In the United States, P&C insurance guarantee funds are managed at the state level. Based on information available for several state guarantee funds (Florida, Louisiana, Pennsylvania, Tennessee and Texas), the size of their corporate Boards ranged from five to nine directors.

The trend toward smaller corporate boards is clear and well established. Optimal board size – where "optimal" refers to the effectiveness of the board and the level of Director participation in board decisions – appears to be in the range of 8 to 11 members.

Recommendation – PACICC should reduce its Board of Directors to a size that experts consider optimal. This would appear to be around 10 members. Reducing the size of the PACICC Board does not require changing the Corporation's by-laws – the change could simply be made by resolution of the Board. However, the by-law could be revised to retain some flexibility – for example, having a Board of not less than five and not more than 10 members. It is also important to ensure that insurance regulators support reducing the size of the Board.

6. Board composition and independence of directors

Issue – What is the appropriate mix of industry and independent directors for PACICC? Would the effectiveness of the PACICC Board be enhanced by recruiting members who may have little direct experience in the insurance industry or regulation, but who could bring other diverse skills?

Findings – During the 2003 industry consultation process focusing on PACICC's future, member companies clearly did not support moving to a fully independent Board – "where no one on the PACICC Board works with a member insurer." However, there was some support for ensuring that PACICC has an appropriate balance between governance by members and by directors from outside of the industry. The key corporate governance message that emerged from the member consultation process was a strongly-held view *that the P&C insurance industry should continue to have a majority on the PACICC Board.*

Effective May 2004, PACICC will have 14 Board members. This includes two staff members (the President and the Secretary-Treasurer), eight volunteers who work in the P&C insurance industry, and four other members. With a smaller Board of 10 members the mix would be similar, involving one staff member (the President), six industry volunteers and three other members.

For PACICC, industry volunteers and other board members are governing "independent" of management, but are they perceived by various stakeholders as being independent? In particular, are the industry volunteers and recently retired insurance industry executives who make up the majority of PACICC's Board perceived as being independent?

There is little doubt that director independence is now widely viewed by authorities as an important contributor to effective governance. Consider the following statements:

> "Demonstrable board independence is at the core of effective governance." (OSFI)
>
> "It is generally believed on a global basis that a board of directors should be composed of a majority of 'independent directors.'" (NACD)
>
> "The board of directors of every corporation should be constituted with a majority of individuals who qualify as unrelated directors. An unrelated director is a director who is independent of management and is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act with a view to the best interests of the corporation…" (TSX)

NACD also believes that director independence has a positive effect on corporate financial performance. In their Director Handbook Series (*The Governance Committee*, 2003), they cite a study showing that companies with a majority of independent directors earned higher returns on equity – ranging from one to six percentage points higher – when compared to companies with a majority of management or inside directors.

But what does it mean to be an “independent director”? According to Carol Hansell:

> “This term has a formal meaning in Canada only in the context of OSC Rule 61-501 (and QSC Policy 27), where it is used in the context of certain types of transactions. Otherwise, the term is used loosely in Canada either to refer to directors who have no relationship with management or to refer to directors who have no relationship either with management or with a significant shareholder.”

John Carver, for example, says that “independence is surely a valuable and necessary commodity in tomorrow’s boards, but it certainly is not sufficient.” Rather, it is the actual performance of the PACICC Board and its ability to act in the interest of stakeholders that should measure effectiveness. OSFI’s own Corporate Governance Guideline appears to support this view, stating that:

> “While certain structures, including those described in this guideline and OSFI’s rating criteria, can encourage independence, OSFI does not view any one structure as guaranteeing independence. What matters is that a particular structure and board’s behaviour are effective, taking into account the particular circumstances of the financial institution.”

Expert opinion on effective corporate governance suggests that PACICC should consider actively recruiting to the Board some members with extensive experience outside of the insurance industry. However, if PACICC is to be consistently successful in securing high-quality directors, the corporation will need to review its board compensation and training practices. These issues are discussed in sections 7 and 10 of this paper, respectively.

Recommendation – PACICC should have 10 Board members that include the President. Six of PACICC’s Board members should be senior executives who are active in the P&C insurance industry and well-informed about current industry issues and risks. Three Board members should have extensive experience outside of insurance and should not currently be working for an insurance company. It is recommended that PACICC adopt the practice of describing these groups, respectively, as its “management director,” “industry directors,” and “public directors.”

7. Compensation of directors

Issue – What level of compensation should be paid to Directors and how should it be structured? Should PACICC continue its policy of compensating only Directors who are not currently employed by its member companies? Should PACICC introduce compensation for attendance or for those who chair committees?

Findings – PACICC currently pays its Directors a fixed fee of $1,000 per year, except for its Directors who are currently senior officers of member P&C insurance companies or PACICC staff. The member-company Directors are considered volunteer Board members and they receive no compensation. PACICC provides no additional payment for meetings attended or for members who chair committees.

PACICC's level of director compensation is well below the averages paid by publicly traded companies in Canada and the United States. Korn Ferry reports that director compensation in Canada in 2002 consisted of an annual retainer fee averaging $17,044, and a per-meeting fee averaging $1,271. Similarly, NACD's 2001 survey showed that director compensation for "smaller companies" involved an annual retainer averaging $9,640 (US). Directors in this category also received additional annual fees averaging $8,086 (US), but this figure was not broken down "per-meeting."

For comparison purposes, levels of director compensation were examined at CompCorp and at the General Insurance Ombudservice (GIO). CompCorp's latest annual report shows that directors' fees totalled $304,800 in 2003, or about 5 percent of total revenue. With 10 independent board members, CompCorp's total annual compensation per director is clearly much larger than PACICC's. GIO, by comparison, paid its Chair and independent directors annual retainers of $10,000 and $3,000 in 2003, plus fees of $2,500 and $1,500 per meeting, respectively. P&C insurance industry representatives who serve on GIO's Board do not receive directors' fees. GIO has five independent directors and two industry directors on its Board.

Despite uncompetitive compensation, PACICC has been successful in attracting highly qualified directors with long and successful careers in the insurance industry, or in the regulation of insurance. These individuals are aware of the importance of PACICC and have largely "volunteered" their time to support the organization.

However, PACICC has not been successful in attracting directors who bring experience and skills from outside the insurance industry and the regulatory community. Uncompetitive compensation has been a factor limiting the diversity of PACICC's Board.

Recommendation – If PACICC decides to recruit independent directors from outside of the insurance industry, the corporation will need to increase its compensation for directors. The PACICC Board should also consider if it would like to reaffirm that participation on the Board by individuals active in the P&C insurance industry should remain on a voluntary basis.

8. Length of service for directors

Issue – What is a reasonable length of time for a director to serve on a corporation's board? Should PACICC adopt a term limit for its directors?

Background – All of PACICC's directors serve for a one-year term – from one annual general meeting to the next. When Board members are nominated and approved every year at the Corporation's annual general meeting, members of the existing Board are either re-nominated or replaced with new directors. To ensure reasonable turnover in Board membership, PACICC could consider adopting a limit on the length of service for directors.

The corporate governance literature is sometimes critical of term limits for directors. For example, the NACD's 2001-02 Corporate Governance Survey found that respondents rejected term limits for board members by nearly a two-to-one margin. A key reason for avoiding term limits appears to be concern that they may result in the loss of valuable accumulated expertise. For example, the Corporate Governance Guidelines of Merrill Lynch & Company – one of the world's largest financial services companies – contains the following statement on term limits for directors:

> "The Board of Directors does not believe it is advisable to establish term limits for its members as such limits may deprive the Corporation and its shareholders of the contribution of directors who have been able to develop, over time, valuable insights into the Corporation, its operations and future. As part of its responsibilities, the Nominating and Corporate Governance Committee will consider each director's continuation on the Board at the expiration of his or her term and before that director is considered for re-election."

To ensure that PACICC's corporate interests are well served, an effective process for evaluating the Board's performance on an annual basis also needs to be implemented (see section 10 of this paper). The results of such evaluation would then be used to help guide the nomination of directors for the coming year. This process could be managed by a small committee of the Board with responsibility for corporate governance (a possible expansion of the role of the current Executive Committee, as discussed in section 4).

Recommendation – PACICC should consider adopting a term limit for its directors. To promote a balance between retaining valuable director expertise and providing new opportunities for PACICC member companies to be represented on the Board, PACICC should consider allowing the term limit to be renewed or extended when circumstances warrant (for example, to allow a director to complete his or her term as Chair). PACICC should also implement an effective process of Board performance evaluation (as specifically recommended in section 11) and ensure that the results are used to help guide the re-nomination of directors.

9. Frequency of Board meetings

Issue – How often should PACICC's Board of Directors meet? Should there be a minimum number of Board meetings and should meetings be regularly scheduled? Should the Board have an attendance policy?

Findings – PACICC's by-laws do not specifically address the issue of how frequently the Board should meet, whether meetings should be held at regular intervals, or what constitutes an acceptable level of director attendance. It has generally been the practice of the PACICC Board to meet at the call of the Chair. Meetings also take place during the initial period following an insolvency of a member insurer.

As part of the effort to improve its corporate governance practices, the PACICC Board should consider increasing the frequency and regularity of its meetings. Standard practice suggests four to 12 Board meetings per year. According to the NACD:

> "[Our] surveys indicate that boards today are meeting more often than in the past. Nearly two-thirds of respondents indicated that boards should meet at least six times per year. Actual board practices vary widely, from a regular schedule of a minimum of four times to a maximum of 12 times per year. In times of crisis, of course, boards often meet very frequently."

In addition, it is considered to be good practice to schedule Board meetings well in advance, and at regular intervals. Regarding attendance at Board meetings, NACD believes that if a director's absentee rate has been higher than 25 percent, "the director should not stand for re-election unless the events causing the absences are highly unlikely to be present in the future."

Another issue that tends to arise is director participation in Board meetings by telephone. Carol Hansell says that this practice, while sometimes necessary, is not desirable:

> "There will, of course, be situations in which it is better for the board or committee to have one or more directors participate in the meeting by phone, rather than losing the benefit of their participation altogether. Boards should, however, resist having this become a regular practice."

Recommendation – The PACICC Board should hold two regular, substantial meetings per year, both scheduled well in advance. For example, the Annual General Meeting (Spring) and the Strategic Plan and Budget Review (Fall) would both become regular commitments on the Board's calendar. Additional board meetings would then be held at the call of the Chair, as required, to address specific issues such as insolvencies. In practice, this would likely add between zero and four meetings per year. Board members should also be encouraged to attend all meetings in person, and an absentee rate above 33 percent should usually result in a Director not being re-nominated (unless events causing the absences were highly unlikely to continue).

10. Director training and education

Issue – What training and education should PACICC provide for its Board of Directors and, in particular, for new members recruited to the Board? What special information would be important for Board members who may have little direct experience with the P&C insurance industry?

Findings – Providing education and training for corporate directors is widely regarded as good practice. It is recommended in various corporate governance guidelines, including those issued by the TSX. Carol Hansell offers some useful observations on the subject:

> "Directors are typically recruited to the board for the experience and expertise that they have acquired over the course of their careers. However, there remains a great deal of work to do in order to stay current with evolving expectations of directors and with the changing needs of the corporation.
>
> The foundation of director education is a well thought out orientation program for new recruits to the board. The orientation program should acquaint a new director with the corporation and its business, with key executives and with external advisors who play a regular role with the corporation.
>
> The other component of director education is ongoing education. Some directors are resistant to ongoing education, believing that they are at a point in their careers where this should no longer be necessary. However, the complexity of most businesses and the pressure on boards to be accountable is driving a new demand for director education."

Resources and programs providing director education are readily available and can be structured to address a corporation's unique business and governance requirements. For example, the Institute of Corporate Directors recently established the ICD Corporate Governance College in association with the Rotman School of Management at the University of Toronto (see www.rotman.utoronto.ca/ execprog/dep.).

PACICC Board members with little direct experience in the insurance industry may welcome and need information about the industry that would differ from the requirements of Board members who have spent their careers in the industry. Most PACICC Board members have extensive experience participating on corporate boards. There is, however, no inventory describing the current governance experience or skills of Board members. Training and education provided by PACICC should reflect the actual needs of members.

Recommendation – PACICC should provide training and education for its Directors as part of its commitment to effective governance. The Corporation should introduce an orientation program for new Directors. In addition, PACICC management should regularly provide P&C insurance industry information and analysis to Directors (note: the current PACICC strategic plan includes a commitment to introduce an annual "state of the industry" presentation to the Board each Spring). Also, development of the Board

Guidelines will include preparation of an inventory of governance experience that may be helpful in assessing training needs.

11. Evaluating the Board's performance

Issue – What performance standards should be expected for the PACICC Board? Who evaluates the Board's performance and what method should be used for this purpose?

Findings – In its Corporate Governance Guideline, OSFI outlines four "hallmarks" of effective corporate governance:

- **Judgement** – making "decisions that strike a reasonable balance between business objectives and risk management and control functions."
- **Initiative** – "proactive exercise of responsibilities" by board members, including a "readiness to both advise and challenge management."
- **Responsiveness** – responding to issues "identified by management, the independent oversight functions and regulators," as well as issues identified by the board in evaluating itself or management.
- **Operational excellence** – establishing processes that "permit discussion and advance consideration of important matters and transactions, based on appropriate and timely information and analysis."

Knowing what criteria make up "effective performance" is obviously important, but, as Carol Hansell asks, "How do directors know when they are getting it right?" To answer this question, it is considered good practice for a board to evaluate its own performance as well as the performance of committees and individual members. As the TSX states in its guidelines on corporate governance:

> "Every board of directors should implement a process to be carried out by the nominating committee or other appropriate committee for assessing the effectiveness of the board as a whole, the committees of the board and the contribution of individual directors."

A means of achieving this objective that is "gaining popularity at a fast pace" according to the NACD, involves a board of directors adopting a "self-assessment" process. A number of groups have developed sample questionnaires dealing with board self-assessment, including the NACD, the American Society of Corporate Secretaries, and the Institute of Corporate Directors. In addition, the Institute for Catastrophic Loss Reduction has successfully implemented a *Board of Directors Review Process* based on a self-evaluation questionnaire that can be used as a model by PACICC.

Recommendation – The PACICC Board should ensure that its performance is evaluated annually. Adopting a self-assessment process that identifies performance deficiencies and helps generate recommendations for improvement would be both an efficient means of evaluating board performance and considered good practice. Drawing upon recommended samples and models in use, PACICC should create an appropriate self-evaluation questionnaire for its Board of Directors. The self-evaluation process should be implemented during 2004.

PACICC Principles and Performance Goals

Principles	Performance goals
In the unlikely event that an insurance company becomes insolvent, policyholders should be protected from undue financial loss through prompt payment of covered claims.	We work closely with the court-appointed liquidator in the winding-up of an insolvent insurer to encourage prompt payment of documented policyholder claims. We strive to settle: • all claims for the refund of unearned premiums within 8 weeks, and • more than two-thirds of first-party liability or damage claims within 12 months of such claims being documented. To ensure that compensation remains fair, PACICC's Board of Directors reviews – at least once every three years – the dollar limits we can pay on claims.
Financial preparedness is fundamental to PACICC's successful management support of insurance company liquidations, requiring both adequate financial capacity and prudently managed compensation funds.	Review PACICC's financial capacity at least once a year to ensure that the corporation is well-prepared to respond to P&C insurer insolvencies. Maintain a well-defined investment policy to ensure the safety of principal and a high degree of liquidity for PACICC's Compensation Fund assets. Report to members annually on the status of Liquidation Fund balances, identifying projected refund amounts by member company where possible.
Good corporate governance, well-informed stakeholders and cost-effective delivery of member services are foundations for success.	PACICC's Board of Directors evaluates the Board's performance and that of management annually. PACICC prepares an annual strategic plan that is reviewed and approved by its Board. The plan is sent to all members and insurance regulators, and is available to consumers. We communicate with members and consumers about PACICC's key activities in a timely manner – primarily through our web site, annual report and strategic plan. PACICC will ensure that the cost of its continuing administrative operations remains at a reasonable level in relation to other compensation fund organizations.
Frequent and open consultations with members, regulators, liquidators and other stakeholders will strengthen PACICC's performance.	We meet and consult at least annually with all of Canada's insurance regulators to share information and analysis on the causes of insolvencies. We meet regularly with our key partners in the liquidation and claims adjusting business, to review priorities and performance and identify improvements. We also work in partnership with other financial industry compensation funds to manage shared issues, including insolvency costs.
In-depth P&C insurance industry knowledge – based on applied research and analysis – is essential for effective monitoring of insolvency risk.	We research and analyze the P&C insurance industry to help PACICC identify improvements in its corporate practices. We make our industry research and analysis widely available to stakeholders.

Key information sources

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5. Industry Canada, Canadian Society of Association Executives, The Canadian Bar Association, and The Canadian Centre for Philanthropy (joint report), *Primer for Directors of Not-for-Profit Corporations: Rights, Duties and Practices*, June 2002.

6. Korn Ferry International (in partnership with Patrick O'Callagan & Associates), *Corporate Board Governance and Director Compensation in Canada: A View of 2002*, December 2002.

7. Torys LLP, Memorandum on Directors' Duties (sent to the Directors of PACICC), February 4, 2003.

8. National Association of Corporate Directors, *The Governance Committee*, Director's Handbook Series, 2003.

9. American Society of Corporate Secretaries, *Governance for Nonprofits: From Little Leagues to Universities*, 2003.

10. The Conference Board, *Corporate Governance Best Practices*, by Carolyn Brancato and Christian Plath, 2001.