“New Subsidiary Governance” for International Banks

An Empirical Study of leading Canadian International Banks

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St. Gallen, May 21, 2013

The President:

Prof. Dr. Thomas Bieger

*To the memory of my namesake, Thomas McGrath Casey,
who in leaving his home country of Ireland and immigrating to Canada
in the early 1900s inspired me to think globally; and to his daughter,
Rita Elizabeth Casey Sears, who taught me ethics and convinced me
that I could accomplish any goal I set my mind to;
and to her life partner, Henry Kenneth Sears, who through his example
taught me how to achieve my goals.*

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Port Hope, Ontario, Canada, 2013 Thomas C. Sears

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Abstract: Corporate Governance in Canadian International Bank Subsidiaries:

Corporate Governance has become a subject of significant attention over the last two decades. Interest grew rapidly in the 1990's when the United Kingdom experienced the Maxwell Affair and the collapse of Barings. Shortly thereafter, the United States was rocked by a recurrence of failures that included ENRON and WorldCom.

This trend of corporate failings drove regulators to react with new Principles and Regulations. The OECD's "Principles of Corporate Governance" quickly led to changes in Corporate Laws in over 2 dozen countries. The United States introduced Sarbanes Oxley imposing new rules for all US listed companies. New governance regulations were being introduced around the world as regulators reacted quickly.

Companies and their Boards embraced these new principles. They did so in part based on the belief that good Corporate Governance could deliver benefits to the corporation and its shareholders. But In spite of these new rules "breaches" of corporate governance continued, causing more corporate failures and losses to shareholder value. Some argue that the 2008 economic crisis, the greatest global recession the world has experienced since the Great Depression, was ultimately caused by poor corporate governance among major national banks.

Why do breaches continue? Why is regulation not enough to accomplish what the OECD, Sarbanes Oxley and others are trying to prevent?

The goal of "good Corporate Governance" is made more complex by the growing trend for businesses to "go global". Setting up operations often thousands of miles away, companies must transcend foreign cultures and national boundaries to ensure that Corporate Governance standards are effectively operating in their international subsidiaries. This research examines how Corporate Governance can be successful both at home as well as across extensive networks to reach international corporate subsidiaries and affiliates.

Many of these troubled organizations over the past two decades have been banks. However, Canada's banks have been ranked by the World Economic Forum as "the World's Soundest Banking System" for 5 consecutive years and weathered the 2008 financial crisis relatively unscathed. Canada's major banks are all very international in scope. What is it that Canada's banks do to ensure Corporate Governance is effectively working in their banks and how do they ensure that their international networks and subsidiaries are also being well governed? Can other international banking systems or other international industries learn from the practices of Canada's international banks?

My research explores how Canada's banks have achieved success in corporate governance both at home as well as with their international subsidiaries. By comparing these best practices with the most recent academic thought and theories, my conclusions provide relevant insight on international subsidiary governance for academics, regulators and practitioners.

Corporate Governance in Tochterunternehmen kanadischer Banken

Das Thema Corporate Governance hat während der letzten 20 Jahre immer mehr Aufmerksamkeit auf sich gezogen. In den 90igern, als Großbritannien die Maxwell-Affäre und den Bering-Kollaps erlebte, wuchs das Interesse rapide an. Kurz darauf wurden die Vereinigten Staaten von einer Reihe spektakulärer Konkurse erschüttert, wozu ENRON und WorldCom gehörten. Auf diese Tendenz zu körperschaftlichen Misserfolgen reagierten die Regulatoren mit neuen Grundsätzen und Vorschriften. Die „Grundsätze für Corporate Governance“ der OECD brachten schnell in 2 Dutzend Ländern Änderungen im Körperschaftsrecht. Die Vereinigten Staaten ordneten mit „Sarbanes Oxley“ neue Regeln für alle in den USA börsennotierten Unternehmen an. Weltweit reagierten Aufsichtsbehörden schnell mit der Einführung neuer Vorschriften zur Unternehmensführung.

Aktiengesellschaften griffen diese neuen Grundsätze bereitwillig auf – zum Teil in der Überzeugung, dass gute Corporate Governance Firmen sowie Aktionären Vorteile bringen könnte. Aber trotz dieser neuen Regeln gab es weiter Governance-Verstöße, was zu mehr Firmenkonkursen und Aktionärsverlusten führte. Es wird behauptet, dass die Wirtschaftskrise von 2008, die größte globale Rezession seit der Großen Depression, durch schlechte Corporate Governance bei führenden Geldinstituten verusacht wurde. Warum gibt es immer wieder Verstöße? Warum reichen Vorschriften allein nicht, um Betrügerei und andere Governance-Verstöße zu verhindern?

Das Ziel „gute Corporate Governance“ wird durch den wachsenden Globalisierungstrend verkompliziert. Wer tausende Kilometer entfernt Niederlassungen aufbaut, muss fremde Kulturen und nationale Grenzen transzendieren, um zu bewirken, dass seine Corporate Governance-Normen in den ausländischen Tochtergesellschaften auch funktionieren. Diese Arbeit untersucht, wie Corporate Governance im eigenen Lande und in ausländischen Niederlassungen und Tochtergesellschaften erfolgreich sein kann.

Viele der in Schwierigkeiten geratenen Organisationen waren Banken. Kanadas Banken wurden allerdings vom World Enonomic Forum 5 Jahre in Folge als „das gesündeste Bankensystem der Welt“ eingestuft und haben die Finanzkrise von 2008 relativ ungeschoren überstanden. Die größten kanadischen Banken sind alle stark international engagiert. Wie stellen sie sicher, dass Corporate Governance funktioniert und dass ihre internationalen Netzwerke und Tochterunternehmen gut geführt werden? Können andere international tätige Banken und Industrien von den Methoden dieser Banken lernen?

Meine Untersuchung erforscht, wie es die kanadischen Banken im eigenen Land und bei ihren internationalen Tochtergesellschaften mit ihrer Corporate Governance zum Erfolg gebracht haben. Ich vergleiche diese optimalen Vorgehensweisen mit akademischem Denken und Theorien der aktuellen Gegenwart, und meine Schlussfolgerungen bieten wichtige Erkenntnisse für Akademiker, Regulatoren und Praktiker.

Part I. Introductory Section

1.1 Problem Analysis:

There are two growing yet conflicting pressures shaping modern business today: globalization and regulation. Recent innovations in communications, transportation and technology have increasingly allowed business leaders to reach outside of their local and traditional markets.[1] And while goods can now be effectively and efficiently delivered around the globe, distinct challenges arise when manufacturing and distribution are expanded into new territories. However increasing pressure from regulators, business investors and corporate boards of directors has resulted in the stricter control and management of business practices. Today, corporate governance plays an increasingly critical role in managing today's successful modern corporation.

The combination of these seemingly conflicting forces – increased international expansion and also the need for tighter control – has increased the requirements and complexities for corporate oversight by boards of directors more than ever before. This dissertation will examine many famous failures in international subsidiaries and affiliates that seriously jeopardized company share value, brand equity, and company reputation. With the expanded scope of their obligations to shareholders and other stakeholders, what must a corporation's board of directors do to effectively carry out their roles of governance and oversight?

Corporate Governance is a relatively new phenomenon. While the term itself is generally attributed to Richard Eells'[2] (1960) book "The Meaning of Modern Business", corporate governance has become the focus of significant attention over the last two decades. One recent milestone that accelerated interest in corporate governance was the 1992 Cadbury Report.[3] Sir Adrian Cadbury, the author of the report, was asked by a group consisting of the Financial Reporting Council, the London Stock Exchange, and the accountancy profession to establish a committee to investigate corporate governance systems in England.

[1] House, R. et al, ((2004), "Culture Leadership and Organizations", Sage Publications, pp. 4-7
[2] Eells, R. (1960), -"The Meaning of Modern Business: An Introduction to the Philosophy of Large Corporate Enterprise" (Columbia University Press.
[3] Cadbury Report, (1992), "The Financial Aspects of Corporate Governance", See: http://www.ecgi.org/codes/documents/cadbury.pdf

The timing of this request followed a raft of corporate scandals in the United Kingdom, most notably one that came to be known as the Maxwell Affair. That same year the Bank of Credit and Commerce International (BCCI) went bankrupt and lost billions of dollars for its depositors, shareholders and employees. The Cadbury Report outlined new best practices for corporate governance in the wake of these corporate scandals.

Just a few short years later, however, the world was again shocked by the collapse of the oldest merchant bank, Baring Brothers, in 1996. Trading losses in its Singapore subsidiary brought this icon of British banking to its knees and resulted in a direct loss of shareholder value, employee jobs and confidence in the international banking system. Regulators around the world were dismayed. The OECD responded by introducing the "Principles of Corporate Governance"[4] in 1999, a document which ultimately led to changes in corporate laws in over two dozen countries. The OECD expanded these Principles in 2004 with new and additional requirements.

Despite these policy-based efforts, business scandals continued to make headlines around the world. The United States had its own share of devastating failures in 2002 through the sequential fall of ENRON, Tyco International, WorldCom and Global Crossing. In reaction to these failures, the US Congress and Senate passed the Sarbanes Oxley Act (SOX) and imposed additional auditing, accounting, and governance control processes on all US-listed companies. Similar regulations were subsequently passed in numerous countries around the world, including Canada, Japan, Germany, France and the Netherlands.

Would these measures be enough to ensure proper governance is occurring in multi-national enterprises? Companies from across all industries did positively respond to these new requirements by making changes to their boards of directors, their board committees and by adding new controls and processes to their operations. Many made changes to their audit procedures and risk management programmes. In addition to these internal measures, external

[4] Organization for Economic Co-operation and Development (1999), "OECD Principles of Corporate Governance"

auditors and rating agencies modified their processes to ensure compliance with the new corporate and regulatory standards. New industry watchdogs also emerged to measure and monitor company compliance to these new principles and rules. One such organization that emerged in Canada was the Clarkson Centre for Business Ethics and Board Effectiveness (CCBE[5]) at the Rotman School of Management, University of Toronto. Since 2002 the CCBE has reviewed all companies on the Toronto Stock Exchange's TSX 300 Index and has ranked each company's adherence to 15 critical practices of corporate governance. In publishing their annual *Board Shareholder Confidence Index*, the CCBE has seen consistent and material improvement by Canadian companies in how their Boards have been constructed and how they have conducted themselves. In 2002, only 34.7% of CCBE's companies scored over 70% on all measures but by 2007 this score had jumped to 63% (See Section 2.1.4 Monitoring Industry Change).

The CCBE's findings demonstrate that companies in Canada have made significant changes to their boards, their company structures and their behaviours. The CCBE findings also demonstrate that regulation has the ability to drive change in organizations and changes in corporate behavior. But the question still remains: can regulation drive good corporate governance? Sadly the answer is no. While regulation has undoubtedly been effective in drawing attention to the need for unified corporate governance and creating laws that promote responsible behaviour, regulations and rules alone are clearly not enough. When one reviews the dates of corporate governance breaches detailed in Section 1.1.1 against the dates when regulations were passed around the world (See Appendix I – "Development of International Corporate Governance"), it is markedly apparent that breaches of corporate governance have continued in spite of new regulation and legislation.

For example, the 1999 OECD Principles of Corporate Governance and the variety of laws subsequently passed in the United States were both in existence when Enron and WorldCom collapsed in 2002. The Sarbanes-Oxley Act also did relatively little to stop the global devastation and lingering financial crisis produced by the US-led subprime crisis of 2008. In fact, the United States saw

[5] CCBE – for more information see: http://www.rotman.utoronto.ca/ccbe/

the single largest act of fraud perpetrated *after* this period of intense regulation through Bernie Madoff's $50 billion hedge fund Ponzi scheme.[6] Outside of the US, 2011 saw the demise of the News of the World in the UK due to significant governance flaws in Robert Murdock's newspaper subsidiary. We must conclude then that the OECD Principles, the Sarbanes Oxley Act and other pieces of regulation and legislation did not prevent these failures or the largest economic collapse the world has seen since the Great Depression. Nor did they prevent other less significant scandals and breaches of corporate governance from happening during that same period. The fact remains: regulation alone does not necessarily eliminate infractions of corporate governance.

Why do these gaps continue in spite of new regulations brought in to prevent these failings? More importantly, why is regulation not enough to accomplish what the OECD and the Sarbanes Oxley teams were trying to address? In complying with these new rules, why do some companies still fail? Insight to these questions can be found by examining the best practices of successful international companies. Other insights are gained in examining the motivational and environmental circumstances that lead individuals to think they can cheat.

Adding tremendous complexity to the Corporate Governance puzzle is the business need for companies to go global by setting up operations, often thousands of miles away and crossing foreign cultures and national boundaries. What must a Board of Directors do to ensure that governance practices and processes are effective not only at home, but also in these foreign jurisdictions?

My research seeks to find insight into how Corporate Governance can be successful in companies that have extensive global reach across their networks of international subsidiaries and affiliates.

Through all of this recent economic turmoil, Canada's banks have been seen as a pillar of stability and strength. As a group they emerged from the 2008 banking crisis relatively unscathed and were listed that year by the World Economic Forum as being "the World's Soundest Banking System". That global ranking continues today[7] for the 5th consecutive year in a row. Canada's banks are very

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[6] Forbes Magazine - http://www.forbes.com/2008/12/12/madoff-ponzi-hedge-pf-ii-in_rl_1212croesus_inl.html
[7] World Economic Forum – "The Global Competitiveness Report 2011-2012", pg. 140

active internationally - the Bank of Nova Scotia, Canada's third largest bank by Assets[8], has operations in over 50 countries around the globe.

What Corporate Governance practices are in place at Canada's international banks? What can other banking systems and other industries learn from these successful international companies on developing, maintaining and ensuring good Corporate Governance practices are effective in every business line and in every country in which they operate, and still be commercially successful?

My research will examine practices and processes that lead to successful governance practices. I will include a review of academic models and theories, including governance theories developed by Dr Martin Hilb of St Gallen University. I will further examine current academic literature on international corporate governance to identify gaps in theories and models in order to present new insights and approaches for regulators, academics and practitioners.

1.1.1 Research Problem:

The conflicting pressures for increased attention to corporate governance while expanding corporate reach and operations around the world creates a complex challenge for governance leaders. Businesses that seek to expand into new markets face new risks as they embrace new geographies and cultures: Will products, services, marketing, sales, operating systems and management techniques transcend geography and culture to be effective in new countries? Will clients, employees and stakeholders respond in the same way as they do at home? Can companies avoid management failures like the ones that McDonalds experienced in Barbados and Bolivia[9] or that Disney nearly experienced with Euro Disney?[10] The risks are undoubtedly high.

Corporate Governance is a term that most businesses discuss, understand and devote time at the board and management levels to make effective within their organizations. Yet we continue to see recurring examples that effective

[8] 2012 List of Canada's Top 5 Banks - http://www.bankingcanada.net/big+five+banks+in+canada/
[9] Wikipedia – McDonald's Former Locations - http://en.wikipedia.org/wiki/List_of_countries_with_McDonald's_franchises#Former_locations
[10] Rapp, D. (2007), 'Euro Disney – a 'Cultural Chernobyl?' – AmericanHeritage.com, See: http://www.americanheritage.com/articles/web/20070412-euro_disney/

implementation has eluded businesses and their leaders.

Most successful organizations attribute their success to the performance and contribution of employees. Every organization recognizes that one of the most critical roles managers perform is the selection and hiring of new employees. During recruitment, managers typically look to hire talented, hardworking and honest team players who will add value both today and into the future. Yet every breach of corporate governance that will be explored was performed by just such an employee. What turns an honest individual who was hand-picked based on their skills into a “rogue trader” or an executive who commits fraud? In the classic case of Barings Brothers, for instance, it is probable that the manager who hired Nick Leeson did not have any inclination that this young recruit would bring down the 233-year old company within 5 years of joining the firm. Since we cannot predict who will become the next Nick Leeson, organizations must insert checks and balances to manage the so-called principal-agency conflict that exists in corporations. We will explore this important dynamic further in Section 2.1.6: Importance of the Human side of Corporate Governance.

What can we subsequently learn from successful companies? Can we identify techniques and processes that provide more effective implementation to better protect an organization against fraud, failure and breaches? This dissertation will address these issues and the larger question of how companies ensure that their governance policies, which are carefully crafted and implemented in their home location, are able to transcend local culture, language, and market realities so that they can effectively operate in an international subsidiary.

As we review failures in corporate governance we observe that they fall into two general categories: activities caused by a “rogue” employee; and violations or misinformation created by senior executives. Although these two very different scenarios have differing causes and circumstances, the “best practices” I am about to explore may well provide insight to solutions to both scenarios. Note that the common denominator in all of the cases of corporate governance breaches that I present, is that an international subsidiary is involved.

A. "Rogue Trader" Breaches - Involving International Subsidiaries:

1. Baring Brothers[11] – 1995:

Singapore—Nicholas Leeson, a trader for the Baring Brothers & Co. bank reduced the market value of the venerable 233-year old establishment from roughly £400 million to £1 via unauthorized trading losses of £827 million.13 Leeson traded futures contracts and Japanese Government Bonds on the Nikkei 225 without authorization while management at Barings, the Singapore International Monetary Exchange, the Osaka Stock Exchange, and other governing bodies in Britain and Singapore disregarded or failed to recognize the potential for financial disaster. Leeson made some bad bets and tried to cover his losses. Many traders have historically been known to speculate without authorization, however, and when they are caught they are most usually fired. Normally the trader and the employer have no interest in publicizing the incident and the employer absorbs any losses that have been created. But Leeson made headlines because he had completely bankrupted Barings; publicity was unavoidable. The collapse of Barings Bank alarmed the world, especially after the recent Maxwell scandal, and the incident sent a shockwave to organizations and regulators across the globe. Leeson was ultimately tried and sentenced to six and a half years in prison in Singapore.

2. Sumitomo Bank[12] – 1996:

London (UK) - Yasuo Hamanaka was an unassuming forty-eight-year-old assistant general manager in Japan who directed the activity of Sumitomo's London copper traders. Regulators suspected that Hamanaka was setting the price of copper and controlling the market at the London Metal Exchange (LME) by rigging trades by using offshore banking accounts to bury losses. Total losses to the Sumitomo parent company were $2.6 (US) billion. Hamanaka was convicted and sent to prison for 8 years.

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[11] "Barings Debacle" – Risk Glossary (http://www.riskglossary.com/link/barings_debacle.htm)
[12] "Sumitomo's Decent into the Abyss" – Business Week, July 1, 1995 (http://www.businessweek.com/archives/1996/b3482041.arc.htm)

3. **Allied Irish Bank[13] – 2002:**

Baltimore (U.S.A.)—John Rusnak, Allied Irish Bank's (AIB) currency trader at its United States banking subsidiary Allfirst, lost $691 million on the foreign exchange markets. Rusnak was seen as taking huge risks, repeatedly doubling up on trades as he tried to reverse losses that went back over 5 years. AIB admitted that there were serious deficiencies in their regulatory systems. Rusnak's questionable activities went as far back as 1997. As a result of this scandal there were calls for the resignation of AIB's CEO and the company subsequently sold its international subsidiary. Rusnak served a seven and a half year prison term and ordered to pay back the full $691 million that he lost. It was demonstrated later that certain AIB executives were aware of Rusnak's trading activities but did nothing.

4. **National Australia Bank[14] – 2004:**

London (UK) – Gianni Gray headed the National Australia Bank's (NAB) currency desk in London, England, along with fellow trader Luke Duffy, the former head of NAB's currency trading business in Melbourne. Both were found guilty of fraudulent currency trades that resulted in a loss of $260 (US) million and both received 16 month jail sentences as a result. Other effects of the scandal included three additional currency traders also received jail sentences and the NAB's international subsidiary was closed. The Melbourne closure affected all employees in that office and undermined consumer confidence in the parent bank, which further caused financial instability and led to the resignation of both its chairman and chief executive officer.

5. **China's State Reserve Board[15] – 2005:**

Shanghai (China) - Liu Qibing was a metals commodity trader on the London Metal Exchange for China's National Control Center of the State Reserve Board. He lost an estimated $800 million (US) by betting that copper prices would go down (shorting the market) and placing extremely large futures orders. Prices rose, so Liu doubled his bet and tried to recover

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[13] The Telegraph (2002), "Allied Irish Accused of Hiding Rusnak Fraud", March 6, See: (http://www.telegraph.co.uk/finance/2755934/Allied-Irish-accused-of-hiding-Rusnak-fraud.html)

[14] Global News Digest (2004), "Australia's largest bank shaken", March 17, See: http://www.bluegreenearth.us/archive/news_archive/2004/news_03_04.html

[15] Washington Post (2005), "New China Stumbles into Old-Fashioned Trading Scandal", Nov 25 http://www.washingtonpost.com/wp-dyn/content/article/2005/11/24/AR2005112400785.html

the initial loss. Prices continued to rise, however, and the losses became too severe. The trading scandal became public and officials in Beijing declared Liu as a rogue trader in an attempt to cover the losses. Liu's subsequent and somewhat mysterious disappearance fueled rumours of his untimely death or possible imprisonment by a now embarrassed Chinese government. Later rumours fueled the controversy when it emerged that Liu was in fact acting under direct instruction by government superiors who were themselves attempting to manipulate market pricing. The full story remains unknown to this day. Liu has never been seen since this scandal broke.

6. Bank of Montreal[16] – 2007:

New York (USA) - A former commodities trader named David Lee at the Bank of Montreal's (BMO) New York office was found guilty of intentionally inflating the value of natural gas derivative contracts over a four-year period in an effort to pad his bonus. The fraud, which is the largest trading scandal in Canadian history, cost BMO $680 million. To make the fraud work, Lee persuaded the New York-based brokerage firm Optional to collude with him by providing inflated valuations of the contracts. The aftermath of this fraud damaged many individuals and companies: BMO wrote off $680 million in losses, saw their share price erode by nearly 3%, and had their reputation damaged by the impending media coverage and investigation by securities and banking regulators; Lee lost his license to trade securities and was personally fined $4.41 million (U.S.) to account for the bonuses he fraudulently received; two other senior BMO employees lost their jobs for their connection to the scandal; and Optional's top two officers resigned after their share price dropped 90%. Shortly afterwards, BMO announced 1000 job cuts as a result of its declining profits.

7. Crédit Agricole[17] – 2007:

New York (USA) - Richard Bierbaum, a credit derivatives trader in the New York subsidiary of Crédit Agricole was fired for unauthorized trading well in excess of his trading limits. Although losses of $353 million

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[16] "Rogue gas trader admits to fraud", Toronto Star (http://www.thestar.com/Business/article/539396) 19/11/08

[17] Bloomberg – "Calyon Trader Fired for Losses Says He's No Rogue (Update3)", 10/10/2007

> significantly reduced bank profits, Bierbaum claimed that he was personally innocent because his trades were reviewed daily by management. The fact that he was trading significantly over his authorized limits fueled speculation that either internal controls were deficient or that management itself was quietly complicit. The case continues to be reviewed and to date no criminal charges have been laid.

Several similarities emerge from this examination of high-profile securities frauds. First, each fraud severely blemished the parent company's reputation. Shareholder value evaporated overnight and the companies often closed offices and exited business they had invested time and money to establish. Second, individuals directly involved in the fraudulent activity lost their jobs, their trading licences, and their careers; most also received jail sentences. Similar fates awaited each trader's supervisory management and other accomplices. Collectively in these cases, thousands of completely innocent parties also suffered by losing their jobs, pension benefits, service credits and stock investments. It is important to note that an international subsidiary was the common denominator in each of these fraud cases. It does make one wonder if these frauds centred on the international subsidiary offices being removed from the direct scrutiny and oversight of the parent company. In spite of the controls these bank and securities companies imposed locally on their operational process, the rogue traders listed here all found gaps in controls, controls which should have prevented or proactively detected the fraud. The fact that the international nature of the subsidiary afforded key advantages for the rogue traders should not be overlooked.

B. Violations by Senior Executives - Involving International Subsidiaries:

Above we explored rogue traders, a term made famous by Nick Leeson but used time and again by many others over recent years. Next we explore what I call rogue executives–senior executives of a firm that intentionally breach corporate governance for their own purposes. Here we clearly see the Principal-Agency conflict that exists in corporations, in which senior executives who are entrusted by the board intentionally misrepresent the performance or strength of their corporations, ultimately to the benefit of their own compensation and bonus systems. Like the rogue traders examined earlier, there are many examples of rogue executives that used an international subsidiary to assist with fraudulent activity. Here are just a few recent examples of this form of corporate governance breach, involving senior executives misusing their authority to create a fraud through the use of an international subsidiary.

8. **Enron[18] – 2001:**
   Cayman – The most famous case in recent times involving a breach of governance occurred in 2001 when Enron used Special Purpose Entities (SPEs), another form of corporate subsidiary, to remove low quality or money-losing assets from Enron's balance sheet. Once uncovered, Enron collapsed. 21,000 employees were dramatically affected by losing their jobs plus any financial security that was attached to stock plans and pensions. Arthur Anderson, one of the world's leading accounting firms and auditor of Enron, also collapsed and took with it 85,000 jobs world-wide. All of this underscores the point that ineffective corporate governance can have on a company, its employees, its shareholders, its stakeholders and the industry to which it is a part. Could a strong system of subsidiary governance have saved Enron and the resultant collapse of Arthur Anderson?

9. **Parmalat[19] – 2003:**
   Cayman – After 30 years as a domestic and family-run organization, the Italian giant Parmalat was listed on the Milan stock exchange in 1991. By 2003, Parmalat had become a global giant in the milk and dairy products industry. The company started to expand with non-core investments including the Parma Football Club and a travel agency, Parmatour, for huge sums of money. To finance its aggressive and rapid expansion, Parmalat raised more than $8 billion in bonds. However serious losses started to form. To conceal these and other losses, Parmalat's founder and now former CEO Calisto Tanzi built a network of offshore mail-box companies, which were made to appear as bona fide assets of the company. The company ultimately collapsed in 2003 as a result of a financial crisis connected to its Cayman subsidiary where it is believed between $8 to 12 billion dollars of debt and investment funds were fraudulently absent. The role of corporate

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[18] McLean, B. & Elkind, (2003), 'The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron', Portfolio Publishing, California, USA

[19] "Parmalat's Bankruptcy" – Executive Intelligence (http://www.larouchepub.com/other/2004/3102parmalat_invest.html)

governance, auditors and the regulators all came under scrutiny.

10. American International Group (AIG) [20] – 2004:

Bermuda – Insurance giant AIG has on a number of occasions used international structures to circumvent or violate US laws regarding reinsurance. In 2004, the US Securities and Exchange Commission (SEC) sued AIG for fraud for an Enron-style structured finance product it sold to its client, PNC Financial Services, a Pennsylvania bank holding company. The scheme attempted to shift $762 million in bad loans from PNC's financial statements to special purpose entities (subsidiaries AIG controlled), increasing its 2001 income by 27 percent. AIG paid $126 million to settle the case. This was not AIG's first brush with failures of corporate governance. In the late 1990's US state regulators became aware that AIG was inappropriately hiding its debts offshore in a Bermuda subsidiary that it controlled. In another case that same year, AIG helped Victor Posner (a partner with Michael Milken in the junk bond fraud) evade taxes by way of an offshore subsidiary. In 2003, the SEC sued AIG for fraud for helping Brightpoint Inc., an Indiana distributor of cell phones, hide $11.9 million in losses through subsidiaries they controlled.

11. Cologne Re Corporation[21] – 2002-2005:

Ireland – The SEC laid fraud charges against 4 senior executives of Berkshire Hathaway's reinsurance subsidiary in Ireland, Cologne Re, for aiding and abetting AIG in committing securities fraud. The executives were found guilty and sentenced to 1 to 4 years in jail as well as financial penalties for helping AIG structure two sham reinsurance structures (listed above: PNC and Brightpoint) with the sole purpose of increasing loss reserves on their balance sheet by $500 million. This action led to executives being fired, the closing of the Gen Re subsidiary, the dislocation of all employees, significant reputational damage to the world's oldest reinsurance company (Cologne Re Germany) and dramatic restructuring of Berkshire's activities around the world. It also led to significant regulatory changes in Ireland (See Section 2.2.1 – C).

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[20] "AIG to pay $126 Million", US Securities & Exchange Commission (http://www.sec.gov/news/press/2004-163.htm) 2004

[21] "SEC charges Gen Re", US Securities & Exchange Commission (http://www.sec.gov/news/press/2005-88.htm) 2005

Were Corporate Governance practices delinquent in all of these cases? Could better Corporate Governance practices have played a role in preventing these failings or in detecting them earlier and in preventing the damage that each of these breaches of governance caused to the company, its employees and its client relationships? Did international cultural differences play a role? What lessons can we learn from these cases?

1.1.2 Research Gap:

Over the last two decades many studies have focused on Corporate Governance but little attention has been dedicated to the particular control mechanisms that successful companies have used to ensure effective corporate governance throughout their international network of subsidiaries. This gap is due primarily to the fact that current research on subsidiary governance tends to focus on the specific role the subsidiary board plays within the larger organization. Kriger and Rich (1987)[22], for instance, examine how Multi-National Corporations (MNC) also referred to by researchers as Multinational Enterprises (MNE) use their subsidiary boards and directors, noting that subsidiary boards in particular can have a range of useful roles including being a value-added tool in increasing the overall corporate vision of the MNC. This article concludes that Subsidiary boards are changing. Kriger (1988)[23] continued his examination on subsidiary boards by conducting additional empirical research on 90 subsidiaries of 36 MNC's based in Europe, North America and Japan, focusing not only on the changing role of subsidiaries but particularly on the increasing role subsidiary boards play in the overall organization. He concludes by distinguishing between 17 specific roles subsidiary boards can play. In all cases there was agreement that these roles were increasing.

Following on Kriger's work, Kim et al. (2004)[24] examined how a transnational corporation's governance structures should be differentiated based on the strategic role the subsidiary plays for the MNC. The emphasis here is again on the role of the subsidiary within the overall corporate framework and Kim et al.'s

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[22] Kriger & Rich: "Strategic Governance: Why and How MNC's are Using Boards of Directors in Foreign Subsidiaries", Columbia Journal of World Business, Winter 1987
[23] Kriger, "The Increasing Role of Subsidiary Boards in MNC's: An Empirical Study", Wiley & Sons, 1988
[24] Bongjim Kim, et al: "Differentiated governance of foreign subsidiaries in transnational corporations: An agency theory perspective", Journal of International Management, 2004

work provides additional insight into the variety of functions that a subsidiary board can play. They note that the subsidiary can be seen by the parent as a local implementer or a specialized contributor if the subsidiary has a global mandate. While this analysis clearly provides useful tools for understanding the various ways a parent company can structure its relations with its subsidiary board, no reference is made by Kim et al. to the particular mechanisms that corporations can use to ensure proper governance is indeed occurring within the subsidiary.

Gillies and Dickinson[25] also examined subsidiary governance. But rather than examining the roles and structures international subsidiaries followed, Gillies and Dickenson were interested in examining the four following specific test hypotheses:

1. The composition of boards of large transnationals is likely to be substantially different from that of national firms;
2. Boards of transnationals will take a leadership role in dealing with the social and economic issues that transcend national boundaries;
3. Boards of subsidiaries of transnational firms are playing an increasing role in the general operations of transnationals; and
4. Boards of transnationals will show a larger concern for stakeholders than boards of national firms.

Gillies and Dickenson ultimately conclude that all four hypotheses are false. It is interesting to note that Gillies and Dickson refute Kriger's earlier findings that subsidiary boards are playing an increasing role in the overall structure of an organization. When asked about this conflict, Mark Kriger in a personal communication to me questioned whether his 1988 research on the "increasing roles" of subsidiary boards was correct. He wondered in particular whether his original sample size of 14 Japanese firms may have been too narrow, or if the respondents may have been biased. These statements suggest that the firms used in his research may have skewed their responses in some way. Alternatively, Kriger wondered if his research simply needed to be repeated and brought up to date, as the advent of Sarbanes-Oxley and other recent regulatory changes have dramatically altered the environment that subsidiary boards operate in today.

[25] Gillies & Dickinson – "The Governance of Transnational Firms: some preliminary hypotheses", Corporate Governance Conference Papers, Blackwell Publishers, Oxford, July 1999

Kriger's conclusion that the "role" of subsidiary boards are increasing and Gillies and Dickinson's contradictory conclusions will be investigated further during my empirical review (Section 4.0).

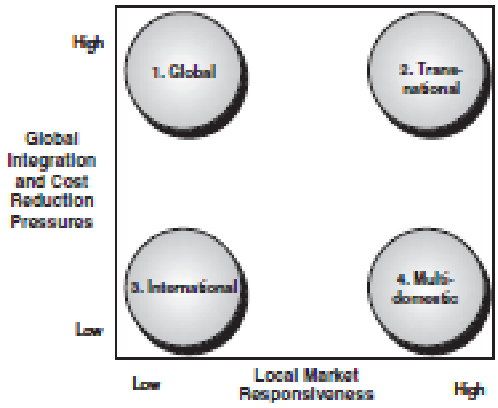
Yadong Luo's (2005)[26] research more directly examines how the global activities of MNC's affect their corporate governance and accountability mechanisms. The relevance of his work for this dissertation is clear. Luo identifies that attributes such as the degree of globalization, foreign adaptation, global competition and international experience all influence the type of governance mechanisms employed. Luo provides several key conclusions concerning the governance of international subsidiaries. They include: 1) while "poor managerial decisions" have contributed to corporate failures, he points to weak boards and "poor independent judgement" that have also led to various corporate governance problems; 2) while some corporate failures may not be directly attributable to corporate governance deficiencies, the existence of governance deficiencies have "played a major role" relative to the scale of the distress; 3) governance needs to be "properly aligned" with the specific attributes of a given MNE, implying the best solution for one firm may be quite different from that of another, and; 4) international expansion increases the ambiguity of executive actions, which in turn increases the risk for classical agency problems for company boards as executives with their specialized international market knowledge have increased ability to provide asymmetric information. These themes will be further explored in greater detail later in my research.

Kiel et al. (2006)[27] further goes on to propose that subsidiary boards are often "perfunctory" in nature. In their research on what are commonly called "puppet boards", Kiel et al. proposes four theoretical frameworks for evaluating governance models in MNC's (See Figure 1): (a) Direct Control; (b) Dual Reporting; (c) Advisory Board; and (d) Local Board. They base these four distinctions on what they conclude are the two critical dimensions for examining corporate subsidiaries: "Global Integration" and "Local Market Responsiveness".

[26] Luo – "How does globalization affect corporate governance and accountability? A perspective from MNE's", Journal of International Management – 11 (2005) 19-41
[27] Kiel, Hendry & Nicholson – "Corporate Governance Options for Local Subsidiaries of Multinational Enterprises" – Corporate Governance Magazine, November 2006

This classification scheme is completely consistent with Hilb's (2006)[28] research on corporate governance of "glocal" companies. These works offer a theoretical lens through which to approach and study options for structuring international subsidiary boards. Essentially, these authors point to the fact that multinational companies need to demonstrate both a shareholder and stakeholder orientation. This clearly highlights the conflicting tendencies of globalization and regulation discussed previously in this dissertation. Hilb's integrated corporate governance ("Reversed KISS[29] principle") and Glocal Framework will be of extreme importance for the empirical research of this dissertation (Section 4).

Figure 1 – Strategies for Entering and Competing Internationally (Kiel)



Research by Ulrich Steger et al.[30] (2005) is also of importance as Steger outlines for the first time specific "mechanisms" and "influencing factors" that MNC headquarters could use to oversee governance of their subsidiaries. This research, which examined the subsidiary governance scandals in both WorldCom and Parmalat, characterized subsidiary governance "as a relatively new field". A key point made early in their study is that "subsidiaries are typically not listed on stock exchanges and are held by only one parent company". Canadian banks with minor exception prefer to wholly own their international subsidiaries. This preference provides important insight to the approach used by Canadian banks to governance and the need to increase "shareholder protection" for the parent.

[28] Hilb, M. (2006), 'New Corporate Governance', 2nd Edition, Springer Publishing, New York, Pg. 22
[29] Ibid, pg. 7
[30] Steger, U., Belloch, J. & Amann, W. (2005), 'The Corporate Governance of Subsidiaries in Multinational Corporations: Theoretical Analysis and Empirical Evidence from Europe', presentation to the IMD Business Forum on Corporate Governance', Brussels

Steger's research is also relevant for this research as it makes a distinction between "soft" governance mechanisms such as culture and "hard" governance mechanisms such as organizational structure and other more formal governance mechanisms. They review "culture" as a controlling mechanism and examine Perlmutter's[31] (1969) theory of ethnocentric management style, employing home-country nationals to manage international subsidiaries and in so doing "transferring corporate culture" to all group entities. These concepts importantly introduce the notion of "soft" control mechanisms as they might apply to Governance on international subsidiaries.

Additionally Steger et al.'s research brings "contingency theory" into the exploration of subsidiary governance as well as the more traditionally recognized issues with agency theory. For our purposes, agency theory mechanisms are quite formal and prescribed. Contingency theory, in contrast, allows for a "differentiated fit" in applying governance to subsidiaries and thus has clear advantages for research on subsidiaries. Steger et al. investigated the importance that MNCs placed on subsidiaries. They found that the influence parent companies would exercise relative to their subsidiary was positively correlated to the subsidiary's size, its place in the MNC's group strategy, the complexity and dynamics of the subsidiary's environment, and the presence of MNC headquarters representatives (expatriates) in the subsidiary's management. Of these factors, sending expatriates into the subsidiary management was found to generate one of strongest mechanisms of cultural control.

While each of these researchers has contributed to the overall knowledge of subsidiary governance, none propose a model of good subsidiary governance or provide a framework for assessing governance in the international context.

We would be remiss in this section of the dissertation if we neglected to highlight the work of Richard LeBlanc[32]. Leblanc is a globally recognized researcher, author and consultant in the area of corporate governance. His book "Inside the Boardroom", co-authored with James Gillies, underscores the need to recognize that international subsidiaries are not simple extensions of the parent company.

[31] Perlmutter, Howard. (1969), "The tortuous evolution of the multinational corporation", Columbia Journal of World Business, 4: 9-18.
[32] Leblanc & Gillies – Inside the Boardroom – How Boards really Work", Wiley, 2005 – pg 41-44

When this is overlooked, businesses may neglect to exercise the same courtesies they normally extend to standalone sister companies. This in turn could have negative implications for subsidiary directors and hinder the potential for the subsidiary to realize its full potential.

Since subsidiaries are strategic or tactical adjuncts to a parent corporation and each true multinational parent will have multiple subsidiaries in various stages of lifecycle and development, a single approach to management or governance will not fit all subsidiaries. In their research on subsidiaries, Molloy & Delaney[33] provide a useful chart (See Figure 2) that examines the evolution of subsidiaries. This chart is a valuable framework not only for understanding the strategic purposes of a subsidiary but also for recognizing the need for flexible frameworks of governance as subsidiaries evolve. This observation supports Steger et al.'s use of contingency theory for the governance of subsidiaries. While the focus of Molloy & Delaney's research was ultimately on the implications for strategy and leadership, the underlying notion is that subsidiaries, like corporations themselves, have life cycles. They also note that both management style and organizational structures will change as a company changes[34] from sole entrepreneur to being a multinational company. Subsidiaries similarly go through their own unique evolutions, highlighting again the need for flexible techniques and mechanisms for governance.

In this section, we focused on existing research to understand the gaps in research from a theoretical perspective. We have reviewed existing research that can be used to guide parent organizations in structuring subsidiaries and subsidiary boards and the internal conditions and corporate strategies that play on subsidiary design and oversight. We have reviewed the implications of Agency Theory for governance and how that applies to international subsidiaries and their boards. We have also seen how Contingency Theory applies to subsidiary structure and design as subsidiaries are not all alike and host countries will differ.

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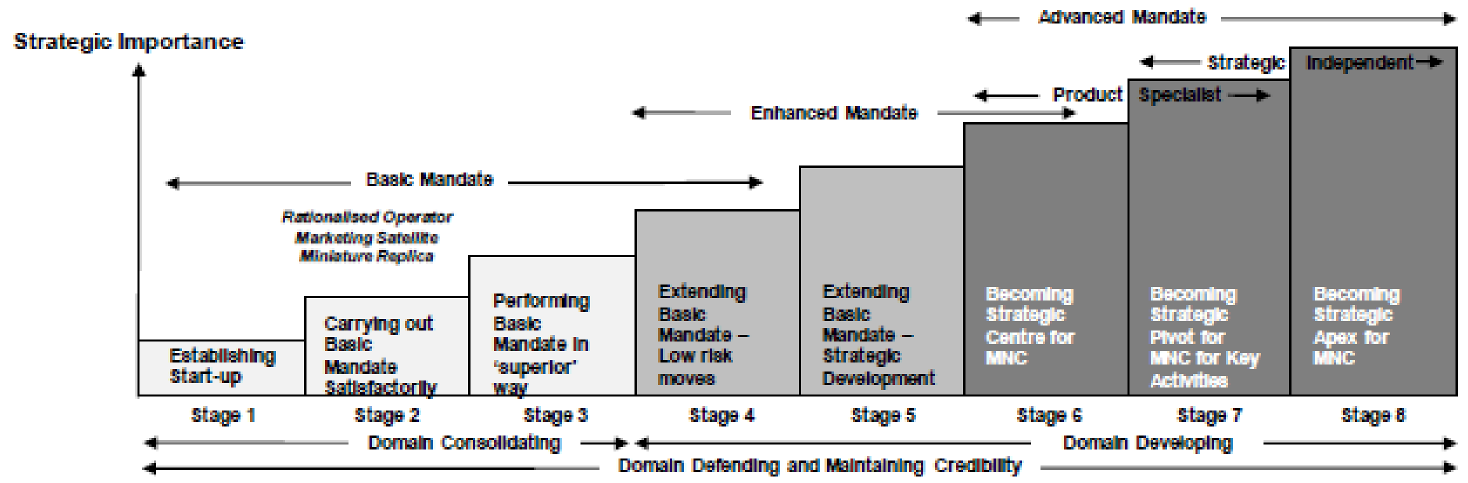
[33] Molloy & Delaney, "Strategic Leadership of Multi-National Subsidiaries", MDL Consultants, 1998

[34] Daft, R. "Understanding the Theory and Design of Organizations" – South-Western College Publishers, 2007

Figure 2 – Stages of Development of a Subsidiary (Molloy & Delany, by permission)



Stages	1	2	3	4	5	6	7	8
Characteristics	Technology transfer. Expatriate managers. Spoonfeeding. Copy exactly.	Up and running according to plan. Parent quite pleased.	Stretch targets set by subsidiary and achieved. Verifiably superior to 'sister sites' or other benchmarks.	Involved in active, low key pursuits of initiatives. Seeking opportunities in 'corridors of indifference'. Taking on corporate projects. 'Toe in the water' of development or services/field activity.	Mandate extended to other value chain activities, openly with parent agreement and budget. Activities now of some strategic importance.	World or regional mandate for some activity (e.g. product, major channel, technology). Responsibility for key functions within the corporation.	High level of autonomy and standalone strategy making unit. Full-line business with significant multi-country linkages and control.	Effectively, the corporate centre for all activities.

Next we will explore why this is important to multinational companies both in theory as well as in practice.

1.1.3 Relevance to Theory and Practice:

In the previous two sections it was shown that international subsidiaries have been at the heart of major financial scandals and breaches of corporate governance. Despite this, no definitive work exists yet that outlines the "best practices" of international subsidiary governance. My research thus has clear benefits for the study and practice of corporate governance.

From a theoretical standpoint alone, I will outline distinct subsidiary governance mechanisms that allow for balance between a corporation's global reach and local effectiveness. I will thus delineate key strategies that businesses can take to surpass the supposed conflict between globalization and regulation. I will utilize Hilb's Glocal Framework for "New Corporate Governance" and examine the potential for subsidiaries to have "a simultaneous orientation for shareholders, customers, employees and the public".[35] In the areas of corporate governance relating to international subsidiaries, this normally implies that company standards like prescriptive mechanisms and hard controls must be globally followed by parent and child businesses within the organization; these are the concerns typically voiced through agency theory. Yet the added demand for all business units to be locally effective requires that the subsidiary remain flexible enough to operate within its local realities; the principles I will suggest in this manner will be more compatible with contingency theory. A key theoretical contribution this research will make is thus to showcase how globally prescriptive mechanisms normally limited to agency theory models can be compatible and interwoven with the local demands for flexibility found in contingency theory.

From a practical perspective, the relevance is more basic and likely more important. The ability to have mechanisms that allow companies to successfully extend the reach of corporate-wide governance to subsidiaries in their local environments has monumental interest for the business community. Current statistics vary but it is generally agreed that the failure rate of new business is high in the first two years and

[35] Hilb, M. – "New Corporate Governance" Second edition, Springer 2006, pg. 22

even higher in the first five years of a company's life. For example Statistics Canada[36] states that "At least half of new companies in Canada go out of business before their third anniversary, and only one-fifth of them survive a decade". This risk of failure is similarly pronounced when companies "go international" and face the concerns mentioned earlier (crossing cultures, languages and regulatory systems), all of which provide added risk to the parent company. The multiple cases of business failure due to inadequate governance mechanisms in international subsidiaries are testament to the practical benefits afforded by this research – if effective governance can be instilled across all components of an organization, the dramatic and far-reaching consequences that arise through its absence can perhaps be prevented. These benefits thus extend to the business itself, the industry it is a part, and the larger social body who are financially implicated in both. Many companies would undoubtedly be interested to know the "best practices" of successful international companies and we can question whether the international subsidiaries of Barings, Parmalat, and Enron would have collapsed if they had been in place from the start.

In a study of Canadian entrants into the United States, Mitchell[37] et al examined Canadian companies entering the American market and concluded that success was predicated on industry conditions at the time of entry and the breadth of experience the firm held in its business line. However there are numerous examples of Canadian companies that failed in attempting to open international operations in the US. They include: Canadian Tire[38] hardware stores, Tim Horton's[39] coffee shops, and Jean Coutu[40], drug stores. More recent examples include Royal Bank of Canada in 2011 selling its banking franchise of 426 branches after 10 quarters of losses and writing off $1 billion after failed attempts to compete in the US South-Eastern banking market[41]. RBC's banking withdrawal came less than one year after its insurance

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[36] Statistics Canada, The Daily (2000), "Failure Rate of new firms", See: http://www.statcan.gc.ca/daily-quotidien/000216/dq000216b-eng.htm

[37] Mitchell, et al, "Foreign Entrant Survival and Foreign Market Share – Canadian Companies Experience in Unites States Medical Sector Markets" – JSTOR, 2002

[38] Sims, L. (1985), *'Canadian Tire's Mistaken Leap into the U.S.'*, Canadian Broadcasting Company (CBC), http://archives.cbc.ca/economy_business/consumer_goods/clips/16903/

[39] Canadian Press (2010), *'Tim Horton's Closes 36 Stores, 18 Kiosks in U.S.'*, CTV News, See: http://www.ctv.ca/CTVNews/Canada/20101111/tim-hortons-stores-101111

[40] Montreal Gazette (2006), *'Jean Coutu shifts Gears into Acquisition mode in Canada'*, See: http://www.canada.com/story_print.html?id=2bfbe5a7-c6ad-492d-9b28-110892edeaa7&sponsor=

[41] Robertson, G. (2012), RBC's Big Southern Withdrawal - Globe and Mail - http://www.theglobeandmail.com/report-on-business/rob-magazine/rbcs-big-southern-withdrawal/article4261677/?page=all

division also withdrew from the United States[42] after 10 years trying to make that subsidiary work and ultimately losing over $400 million. These Canadian companies held strong brand value and experience in their industries and entered the United States generally at a time of economic opportunity.

While these are important cases we can conclude that there is more to success in a foreign market than just the experience and industry conditions raised by Mitchell et al. Success in international business ventures has global and practical relevance for all multinational firms and firms that may be contemplating international expansion. Would the same mechanisms that allow for glocal governance also provide needed additional capability for success in international expansion?

The answer is not obvious but I propose from a practical perspective that being aware of one industry's successful "best practices" and considering them for implementation could only have positive effects on a multinational company's success. While Governance issues were not at play in these cases we can wonder if "best practices" of corporate governance had been stronger whether these failed Canadian subsidiaries might have generated better economic success for their parent organizations.

It is no surprise then that this research has had recurring encouragement from academics, practitioners, bankers and industry regulators. The noted absence of research on international subsidiary governance has made the time ripe for the analysis that I am undertaking. Every person approached for an interview – including bank chairmen, CEO's, regulators and board directors – all unhesitatingly agreed to participate; not a single person declined to be interviewed and many expressed personal interest in this markedly deficient area or research. Their enthusiasm for my research is itself evidence of the theoretical and practical benefits that follow from it.

I believe that my analysis has direct relevance to both the academic world and to the business world and will be of interest to both audiences from a theoretical perspective as well as a practical perspective. Next I discuss the motivation that has led me to this research, including both academic interests as well as personal interests.

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[42] Reuters (2010), *'RBC to sell Liberty Life for $628.1 mln',* Oct 22, 2010 - See: http://www.reuters.com/article/2010/10/22/libertylife-royalbank-idUSN2216847220101022

1.1.4 Motivation for Research:

The motivation for this book is both academic and personal. My career spans over thirty years in financial services with nearly half of that time overseeing international business units covering global private banking and trust, global custody, and international reinsurance. During my career I have seen the devastation that employees shareholders, and other stakeholders face when corporate governance is absent or ineffective. My first employer was Royal Trust, a venerable Canadian institution that provided financial services to thousands of families over its 100-year existence. Despite this, Royal Trust suffered a complete collapse of shareholder value in 1993 because of risky management investments in its European and U.S. subsidiaries. It is important to note that these management decisions were not challenged by the board. Royal Trust collapsed. Many employees lost their jobs as well as their savings and many other trusting stakeholders were crushed by the loss of their investment.

A number of other experiences shaped my interest in corporate governance with particular interest in governance of international subsidiaries. In 1996, when I headed an international subsidiary in London England, one of my close acquaintances worked for Baring Brothers Asset Management. When Barings collapsed because of Nick Leeson’s actions in their Singaporean subsidiary, all Barings employees were sent home. Shareholders again lost their investments and thousands of 30 employees lost their jobs. Later when I headed another international subsidiary in the Channel Islands, a family friend lost his executive job at Arthur Anderson. The collapse of Enron reached far beyond the borders of the United States and not only wiped out the 21,000 jobs at Enron but also all 85,000 employees who worked at Arthur Anderson around the world. The fraudulent behaviour by a handful of overzealous Arthur Anderson employees in Texas brought down one of the world’s Big Five accounting firms and seriously disrupted the lives of thousands of innocent employees, including some highly respected professionals thousands of miles away.

Another personal example occurred in 2004 when AIG was charged with manipulating the financial results of a client through a finite insurance structure in its Bermuda subsidiary.47 Then Attorney General of New York, Elliott Spitzer, commenced a gregarious attack on reinsurance companies in many international jurisdictions. At that time I was Chairman of the International Insurance Association in Barbados. Although neither my own company nor I was in any way connected to the AIG fraud and nor was the fraud directly or indirectly connected to the Barbados insurance or reinsurance industries, by mere association the industry group that I headed, as well as the entire country of Barbados, were placed by association in a very negative light. Because of this breach of governance by a subsidiary in Bermuda, we thousands of miles away were required to defend the reputation and integrity of the country and the industry to the U.S. Press and U.S. regulators. As in the prior cases when breaches of governance occur, innocent parties suffer. In this case the fraudulent activities by an AIG subsidiary in Bermuda brought into question the reputation of reinsurance industry players in completely different international jurisdictions.

This issue of reputational damage was further heightened when Spitzer's audit team identified that AIG had involved a subsidiary of Berkshire[48] Hathaway in Dublin, Ireland. Spitzer said that Berkshire's Irish subsidiary, Cologne Re., had "violated or aided and abetted violations" of securities laws by misrepresenting client financial statements. The executives involved were served Wells Notices and prosecuted in U.S. criminal court. The Irish subsidiary was eventually closed and all Irish employees lost their jobs as well as many head office employees in Cologne Germany.

As a direct result of the embarrassment caused by Cologne Re.'s subsidiary, the Irish insurance regulator responded by fast tracking new reinsurance regulations on the entire Irish reinsurance industry. Many of these new regulations were viewed to be harsh and overly-bureaucratic. Practitioners in the Irish marketplace who had been acting with proprietary and good governance suddenly were forced to add additional layers of administration and cost, in order to present the façade that Ireland was a well-run jurisdiction. Ireland now finds itself with a declining outlook after being the fastest growing economy[49] in Europe for over fifteen years.

As we follow the sequence of issues that affected AIG, then Gen Re and then the Irish Regulator we can also notice the effects of a negative spiral caused by the breach of corporate governance at AIG, spilling over to Gen Re which in turn spilled over to the Irish Regulator. All parties were negatively affected; and all parties had severely damaged their reputation. Reversing this negative spiral would take huge efforts and costs and take many years to recover. In the case of AIG and Gen Re, both exited business lines that had previously proven to be profitable, due to a single bad incident. In the case of the Irish regulator they launched an aggressive campaign to introduce wide ranging regulations, severely affecting all industry members in Ireland.

From a personal perspective I had many friends and associates seriously affected by these breaches of governance. As someone who had managed international subsidiaries for over 15 years, I wondered why some subsidiaries, like mine seemed to not be hampered with these disasters while other got themselves and their parent organizations into trouble. Was it something I was doing? Was it the parent? Was it the regulators or the environment? Was it simply good fortune? Or worse yet, was it simply a matter of time before some crisis was to come my way?

As the head of several international subsidiaries I would lose sleep on these questions. As a self-proclaimed perpetual student I was willing to spend the time researching these questions: How should business leaders and boards of directors act to ensure that shareholders, employees, and other stakeholders do not experience the consequences of ineffective corporate governance as I had witnessed? I believe that research in this field is crucial if we are to increase the likelihood that good governance regularly occurs in the international subsidiaries of multinational corporations.

1.2 Research Objectives:

The above examples demonstrate the tragic consequences that can occur when an international subsidiary becomes the host for fraud and other breaches of corporate governance. Companies that have gone bankrupt, lost vast sums of shareholder wealth, or suffered irreparable reputation damage might have been lacking experience and perhaps might not have ventured onto the international stage had they been aware of the risks associated with international subsidiary governance.

Yet we know that "going global" is not only a strategy of growth but also a defensive strategy to remain competitive in the current marketplace. As businesses and industries go global, will we also see a percentage of these companies critically affected when their subsidiary ultimately goes rogue? Boards of Directors who approve these strategies have responsibility to their shareholders to ensure that adequate precautions are taken to ensure that the subsidiary operates successfully and does not damage the parent company.

This research is targeted at determining why some companies do well internationally. Best practices that prevent failures, and the mechanisms that prevent international subsidiaries from becoming vulnerable to fraud and corruption, are investigated. This will force us to further examine how to address factors like geographical distance or cultural gaps between the corporation's head office and its local environment.

Given the list of cases detailed above, it is also intriguing to note that many of the most devastating corporate failures were banks. Banking requires public trust and confidence, yet we regularly observe breaches culminating in 2007 and 2008 with the worst financial crisis since the Great Depression as banks in the United States, the UK, and Europe failed sequentially. Yet during this time we also observe that Canada was relatively unaffected. The World Economic Forum ranked Canada as #1 (of 134 countries) for "Soundness of Banks"[43].

The banking crisis led to a global economic recession, the results of which have been dramatic, including global banking contagion that affected most of the world's economies and causing unprecedented levels of unemployment and corporate and government bailouts.

More recently we have seen the collapse of the Irish[44] banking system and the subsequent bailout it required. This reversal of fortune for the country once proclaimed as the "Celtic Tiger"[45] by Morgan Stanley in 1994 and which became the fastest growing economy in Europe for 15 consecutive years, was chronicled in the book, "*Ship of Fools*" by Fintan O'Toole[46] which describes the collapse of the Irish real estate market, coupled with less than adequate regulators and fueled by poor governance practices, plus fraudulent business and political activities.

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[43] Schwab, K (2011), *'World Economic Forum: The Global Competitiveness Report 2011-2012'*, See: www3.weforum.org/docs/WEF_GCR_Report_2011-12.pdf

[44] The Telegraph – "Ireland's banking Crisis Timeline" - http://www.telegraph.co.uk/finance/financialcrisis/8419616/Irelands-banking-crisis-timeline.html

[45] Murphy, A – "The Celtic Tiger – an Analysis of Ireland's Economic Growth Performance" – European University Institute, pg 3

[46] O'Toole, F. – "Ship of Fools" – Faber and Faber, 2009

The Canadian banking system seems to have emerged unscathed from these recent crises. It is crucial that we seek to understand what allows this industry to avoid the governance pitfalls that plagued other banking industries. The international subsidiaries of Canada's banks are the ideal group to examine for successful industry and governance practices. Specific attention will focus on the role governance plays both at home as well as across international networks of operation.

What can we learn about the Canadian International banking industry that sees this industry being rated as the soundest banking system in the world by the World Economic Forum? What role does Governance play? How is that Governance exported across their international networks to their international subsidiaries? What role does regulation play? Does regulation ensure good governance? What else might be happening in these Canadian banks that generate recurring accolades for being "sound"? This leads us to our core research question and sub-questions:

The core question and sub-questions of this Research and Dissertation are the following:

- How are Canadian Banks successful in corporate governance, both at home and abroad?
    - What are the dynamics of the bank boards of directors that drives this success?
    - How do the boards ensure that subsidiary boards are "integrated" within the governance objectives of the parent company?
    - What role does the regulatory regime of the parent have on ensuring that subsidiaries are working effectively outside of national boundaries for governance purposes?
    - Can we develop theories and frameworks for boards of directors to follow as best practices for managing and overseeing the operations of international subsidiaries?

These research questions are at the heart of determining "good corporate governance" standards and, as a result, reveal much about the situations that follow when they are absent. The objective of this research is to further the theoretical knowledge base in this area and to make practical recommendations for the successful corporate governance of international banks. This is my research objective.

1.3 Methodology:

In this section I will outline the scientific approach that has guided my research on corporate governance. My specific focus is to theorize how "good corporate governance" can best be achieved in multi-national banks and extended to international subsidiaries. The theory that is being developed in this study is arrived at inductively based on an examination of best practices of corporate governance that occur within Canada's international banks. I subsequently extend my investigation to examine how these practices are successfully conveyed to the international subsidiaries of Canadian banks. Specific details on the process and approach of my research are outlined in Section 3.3 "Research Methods and Design".

Qualitative versus Quantitative Research

Designing a research programme that focuses on corporate governance is complicated by several factors, notably: the relative currency of the subject; the fast pace of change in regulatory and in-house organizational environments; and the reality that corporate governance can be viewed to be as much an art as it is a science. It is my contention that circumstances that generate good corporate governance will vary based on a given bank's specific dynamics and unique circumstances. As corporate governance is very difficult to quantify, researchers have most recently opted to use a qualitative rather than a quantitative research strategy.

Much debate has ensued on the research strategy to be followed in research of management. Management is an evolving and ever-changing set of practices. It is often referred to as a management science, implying the use of a quantitative research strategy to collect and process data using statistical procedures. But more recently, management science has been aligned with the social sciences, which also admit the validity of a qualitative research strategy. In a qualitative approach, a researcher collects data expressed in words, focusing on how research subjects perceive or understand something, and these data are not easily handled using statistical procedures.

In designing a research programme in the area of corporate governance, all researchers will face the dilemma of whether to follow a qualitative or quantitative research strategy. A quantitative strategy relies on numbers that emanate from large sample sizes and result in observations that prove or disprove theories. Sobh and Perry[47] propose that some researchers like Easterby-Smith, et al (1991), may use only one strategy while others like Borch and Arthur (1995) or Hyde (2000) "suggest that both types may sometimes be appropriate". Though these two different strategies may produce contradictory results, according to Patton[48] "it is likely that quantitative methods and qualitative methods will eventually answer questions that do not easily come together to provide a single well-integrated picture of the situation".

From a practical perspective we know that corporate governance is a new and evolving research topic. Literature on the history of corporate governance is limited to the last two decades. Finding ways to measure corporate governance is difficult, which tends to force researchers to find and label examples of "bad corporate governance" (bankruptcies, fraud, bad decisions by boards) after the fact and then examine what variables might have led to those consequences. Results are difficult to verify empirically, as companies with the same dependant variables identified by the researchers are not necessarily paired with the same independent variable from one study to the next. "Hard data" (i.e. quantitative data expressed in numbers, percentages or rates) are not readily available. In the end, adopting a strictly quantitative research strategy, making comparisons between dependant and independent variables, becomes an awkward exercise and makes it difficult if not impossible to derive conclusions.

For example, while it is generally agreed that smaller-sized boards make for better board dynamics, does having a larger board lead to frauds and other breaches of good governance? Pozen[49] argues that Citibank with 18 members on their Board may have been guilty of "group think" and/or "social loafing" which led ultimately to the crisis of a $22 billion loss caused by their involvement in sub-prime debt. But is there any empirical evidence that a large board (dependant variable) leads to poor corporate governance (independent variable)? In an interview with Robert Pozen from his office at Harvard Business School (June 30, 2011, by phone) Pozen acknowledges that there is more to good corporate governance than just the variables of board size, split CEO/chairman and board diversity. As we have seen with regulation that has imposed rules around these board variables, these rules have not stopped breaches of

[47] Sobh & Perry – "Research Design and Data Analysis in Realism Research" – European Journal of Marketing Vol. 40 No. 11/12, 2006 p. 1194

[48] Patton, M. – "Qualitative Research Methods", Sage, London, pp 464-5

[49] Pozen, R – "The Case for Professional Boards" – Harvard Business Review, December 2010, p 3

governance. We need to determine what organizations that experience "good corporate governance" are doing, and we can only get these insights by talking directly to the leaders of these organizations.

Quantitative Research Strategy

Researchers in governance have a choice of research methods to adopt: experimental research, opinion-based research, and observational research. Experiment-based (testing) and opinion-based (survey) research methods tend to generate quantitative data that rely on the use of quantitative data analysis techniques. Observational research methods differ from participant-observation methods in that in the former researchers observe phenomena without interfering too much. In the social sciences, observational research methods are often used in conjunction with a case study research design, to study the behaviours of members of a group in a way that the observer does not influence their behaviours.

Table 1 – Fundamental Differences between Quantitative and Qualitative Research Strategies

Approach to:	**Quantitative Research:**	**Qualitative Research:**
Theory:	**Deductive Approach** (Hypothesis/Theory Testing)	**Inductive Approach** (Generating Theory)
Epistemology:	**Natural Science Approach**	**Interpretive Approach**
Ontology:	**Objectivist**	**Constructivist**

(Source: Own - Adapted from Bryman and Teevan - 2005: 27-37)

One weakness of this approach is that it is very difficult for other researchers to replicate the results of any given observation. That said, this approach offers unique insights and is useful as a method to identify theories in advance of quantitative (replicable) research to test the relevant theories.

In adopting a qualitative research strategy I recognise that there are three fundamental points of difference between a quantitative research strategy and a qualitative research strategy – See Table 1.

Theory

While there is a tremendous body of theoretical work on the area of corporate governance, most of it has focused on issues of Principal-Agency Theory. Little attention has been devoted specifically to theories of good corporate governance. I will have direct access to an esteemed group of leaders in Canadian banks that possess direct insight and knowledge of good corporate governance in the Canadian banking system. This very knowledgeable group of insiders will provide important insights to add to the body of work in corporate governance and allow me to develop new theories on good corporate governance that can be examined and tested in later research. As there is little measurable data in the field of corporate governance, and as the relationship between corporate governance structures and any conclusions can only be tentative at best, a deductive approach to hypothesis testing is not appropriate for this research. Instead I will be following an inductive approach in order to generate new theories about corporate governance.

Epistemology

Following a qualitative research strategy implies an interpretivist epistemological orientation. I will develop and conduct a series of interviews with a cross-section of senior Canadian bank executives, board directors, chairmen and other industry experts. My interview structure will follow a deliberate pattern of questions about good corporate governance in each interviewee's bank and in the banking industry in general, and will be carefully crafted to allow respondents to provide their own perspectives on the elements of good corporate governance. Interview questions will be open-ended and will not strictly guide the respondents' replies. These so-called unstructured interviews will provide information that is top of mind to each interviewee and pertinent to them in the quest for good corporate governance.

Ontology

A qualitative research strategy implies a constructivist ontological orientation. Data collected from interviewees, each of whom is a Canadian bank leader, or industry expert, will be compared for similarities and differences of opinions. By comparing respondents' answers I will be able to observe the common mechanisms for good corporate governance across international banks and banking networks. From these observations I will induce theories for further testing and analysis.

In summary, I will be following a qualitative research strategy entailing a constructivist ontological orientation, and an interpretivist epistemological orientation from which I will develop theory inductively. I recognize that by adopting a qualitative research strategy it will be difficult for me to predict exactly where the interview process will go or what theories I will ultimately construct as a result. This is in fact the strength of qualitative methodology and the objective is to work inductively to generate theory as an outcome of the research.

Research Design

Researchers following a qualitative research strategy recognize the increased need to focus on reliability, replication and validity.[50] These methodological principles have special challenges in qualitative research. As discussed above, following a quantitative strategy lends itself better to experimental, cross-sectional and longitudinal research designs. Although qualitative strategies can also follow a cross-sectional design exploring many cases at a single point in time, my research will follow a case study design. While it could be argued that by interviewing leaders in Canada's top five banks my research design might appear to be a cross-sectional design exploring 5 separate cases (i.e. five banks), the premise for my research is that Canada's banks, *as a group,* are seen as the most stable banking system in the world. For this reason I have chosen to approach them as a single "case". I will conduct open interviews with senior banking executives and other selected "experts" (see Section 3.2 Target Group) to obtain insight into the processes and circumstances (independent variables) that allows "good corporate governance" (dependent variable) within Canada's banks to extend through to their network of international subsidiaries.

Some researchers who follow a qualitative or case study approach may feel that issues of reliability, replicability and validity are less of a concern for them. In seeking insight into "good corporate governance" I see these design issues as central to my research. I propose to address them in the following ways:

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[50] Bryman A. and Teevan, J. – "Social Research Methods – Canadian Edition", Oxford University Press, 2005 p 25

- **Reliability:** in seeking to generate reliable insight and conclusions on "good corporate governance" within Canada's international banks, I will structure my research interview to target Canada's banking leaders – including Board Chairs, Directors, CEOs and Chief Risk Officers (CROs). I will compare and contrast data gathered across Canada's five major banks in order to seek correlation and validate this data by further triangulating with information collected from non-bank executives who possess pronounced expertise in this industry (such as regulators and academics). Further I will obtain the views of experts outside of Canada (UK: Sir David Walker[51], and the United States: Robert Pozen[52]) to further correlate my findings with experts from outside of Canada. Speaking to the most senior and knowledgeable leaders in Canadian banking should reduce any concerns about the reliability of my conclusions, but by adding a second layer of triangulation to include Canadian experts and a third layer of triangulation with non-Canadian experts, is intended to increase the reliability of my findings.

- **Replicability:** although replicability of my analysis and the resultant conclusions is a concern for any qualitative research strategy that occurs at a particular moment in time, I propose that the carefully selected target audience for my interviews would provide essentially the same insights to the same questions asked under similar circumstances. Though times change no less than the biases of both the interviewees and interviewer, the subject of "good corporate governance" in Canada's banking system is specific enough to provide similar (although not exactly the same) responses from interviewees. To this end I feel comfortable that my design and approach will minimize concerns about the replicability of my research findings.

- **Validity:** this is the area of most concern. Can the findings of this research project be extended to other populations? Will they be relevant to other Canadian industries or to banks in other countries? Banking within Canada admittedly has several unique features that differentiate it from other industries. These factors include: significant regulation and government oversight, which includes international oversight and regulations (OECD, Basel, FSB, etc.). Canadian banks uniquely also enjoy the inability to have foreign ownership and thus foreign takeovers and

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[51] Sir David Walker is former Chairman of Morgan Stanley International, who led a UK government inquiry into the failures of banks in the United Kingdom in 2008, which came to be known as "The Walker Review".

[52] Robert Pozen is former Chairman of MFS Investment Management, and a lecturer at Harvard University. He chaired the SEC's advisory committee after the 2007-2008 US banking crisis which resulted in his book "Too Big to Save".

nationally in Canada have very few competitors. These forces make the banking industry in Canada unique and may diminish the ability to extend my findings to other Canadian industries. Similarly, the ability to extend my conclusions to banks in other nations may be hampered by systemic and environmental issues that pertain uniquely to Canada. These include the specifics of Canadian culture, regulatory environment, economy, banking structure (i.e. a small number of large national banks). Despite this, I propose that the findings of my study will be of crucial interest to other Canadian industries as well as to banks in other nations because the principles and best practices put forth in the Canadian context can in fact be replicated in other arenas and industry sectors. It is necessary though to recognize the differences that do exist between any two contexts when attempting to adapt qualitative observations and conclusion to other circumstances. With this caveat in mind, validity is possible.

In summary, my research will follow a qualitative research strategy and use a case study design. It will focus on a highly selective group of interviewees from Canada's major international banks and triangulate their responses with experts in the field of governance.

Data Collection and Analysis

Data will be collected through a specifically structured set of interview questions that give the interviewee flexibility when responding to questions. The questions are themselves meant to invoke personal experience or examples that the interviewee feels is relevant to the topic of corporate governance. Questions will be formed around three major themes:

- **Corporate Governance at the Top:** These questions will center on the interviewee's experience with their bank's corporate governance practices, the operation of its Board (including its Risk Management Committee and Directors), and the banking system in Canada generally as it pertains to corporate governance. The intent is to gather any lessons learned from prior experiences.

- **Corporate Governance at their International Subsidiaries:** The purpose of this set of questions is to examine how governance practices at the interviewee's bank extend to its international subsidiaries. Examining how the main board interacts with subsidiary directors will also be investigated.

- **The Future and Final Thoughts:** By asking interviewees if they had any other thoughts they would like to offer on this subject, I hope to get at their sentiments concerning the future direction of international corporate governance, especially as it relates to subsidiaries. Probing for additional comments gives interviewees the opportunity to discuss any topics or themes that I had not originally accounted for.

Specific detail on my data collection process along with the exact set of interview question is presented in Section 3.3 "Research Methodology and Design".

For data analysis I will follow a grounded theory approach supported by NVivo as computer-assisted qualitative data analysis software (CAQDAS). Strauss and Corbin (1998) defined grounded theory as "theory derived from systematically gathered data, arising through the research process"[53]. Following the formula originally developed by Glasser and Strauss (1967),[54] grounded theory has become the most widely used framework for analyzing qualitative data[55]. Bryman and Teevan (2005: 283) point out though that researchers need to be aware of the "considerable controversy in what grounded theory entails". The central features are the development of theory out of data and an iterative approach to analyzing and understanding the data. This entails that data collection and analysis occur in tandem and cyclically refer back to each other as the research unfolds. The outcomes of grounded theory are:

- **Concepts** – the building blocks of theory; developed through coding and the labels assigned/attached to discrete phenomena
- **Categories** – encompassing two or more concepts, categories and core categories form higher levels of abstraction
- **Properties** – the attributes or aspects of a category
- **Hypothesises** – the initial hunches about relationships between concepts and are the early associations that lead eventually to theories
- **Theories** – a well-developed set of categories

[53] Strauss A, and Corbin J. – "Basics of Qualitative Research: Techniques and Procedures for developing Grounded Theory", Thousand Oaks, Sage p12
[54] Glaser B. and Strauss A. – "The Discovery of Grounded Theory: Strategies for Qualitative Research" – Aldine Transaction, USA, 1967
[55] Bryman A. and Teevan, J. ibid, p 283

In this research context, theory emerges as a result of categories that themselves arise systematically through statements made by interviewees. This then forms "a theoretical framework that explains some social or …. other phenomena"[56]. To develop these outcomes, grounded theory breaks data down into component parts (coding) to the point at which additional data is not required (theoretical saturation), thus maintaining a close connection between data and conceptualization (constant comparison) so that the "theoretical elaboration of that category can emerge"[57].

Bryman and Teevan advise that researchers who use a grounded theory approach for data analysis need to be aware of its criticisms[58] and limitations. First, to say that a theory is grounded does not simply imply that an explanatory model that a researcher develops is in some way associated with (or "grounded" in) certain data. The specific methodology of this approach needs to be followed in its entirety to allow theories to emerge. Bryman and Teevan challenge researchers to put aside their personal desire to theorize before the data is itself fully gathered. That is to say that grounded theorists must allow theory to emerge from data without some active intervention from the researcher. Bryman and Teevan also caution that critics of grounded theory may challenge whether this approach actually generates theory at all, maintaining instead that it simply generates concepts or observations. Another weakness of this methodological approach is that the process of coding may fragment highly contextualized and complex situations into fixed and static points of reference.

As discussed previously, the difficulty in forming and conducting a qualitative research design in this particular area of corporate governance is very difficult and the benefits of conducting this research clearly outweighs the possible disadvantages listed above, This said, I will be cautious of the concerns listed above in mind as I commence my research using the tools of grounded theory to develop concepts, categories, properties, hypotheses and ultimately theories on corporate governance.

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[56] Strauss A, and Corbin J. –ibid, p22
[57] Bryman A. and Teevan, J. ibid, p 284
[58] Ibid – pp 288-289

1.4 Definitions and Key Terms:

Agency Theory[59] or Principal-Agency Theory of Corporate Governance – is the management theory that recognizes a potential for conflict that exists between owners of a firm (the principals) who entrust employees (the agents) to effectively manage the organization to the best interest of the principals and not the best interest of the agents. This theory recognizes the human dynamic for people (agents) to wish to better themselves and in this relationship they could attempt to better themselves at the expense of the principal either through direct misbehaviors (stealing, frauds, etc.) or by presenting false or misleading misinformation (information asymmetry). To address this potential for conflict, principals seek to structure the behaviours of agents through work objectives and mandates tied to performance compensation, as well as by control mechanisms to guide and monitor the actions of agents. In modern organizations, the board of Directors has been charged with the responsibility to oversee the CEO and Management (agents) to ensure they perform in the best interests of the owners and all stakeholders. This is also called the principal-agent problem.

Breaches of Corporate Governance – A breach of corporate governance is a breakdown of controls or processes that results in a corporation breaking the laws of the land or running against the best interests of owners and shareholders. This may be caused by either intentional behaviours of employees or executives, or by bad decision making by management. Examples would include rogue securities trading by an employee, corporate frauds by an executive or management decisions that are clearly determined to be not in the best interests of Shareholders and other stakeholders.

CCBE[60] – The Clarkson Centre for Business Ethics and Board Effectiveness (CCBE) was formed in 1988 and today serves as a leader in corporate governance research and communications located at the Rotman School of Management, University of Toronto. Its mandate is to monitor Canadian corporate governance trends and to provide guidance to firms looking to improve their board effectiveness and disclosure.

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[59] Eisenhardt, M, K. (1989). "Agency theory: An assessment and review." Academy of Management, The Academy of Management Review, 14(1), pp. 57

[60] See: www.rotman.utoronto.ca/CCBE

CCGG[61] – The Canadian Coalition for Good Governance was founded in 2003 by institutional investors to promote effective governance practices in companies whose members include pension plans, mutual fund investors, third-party money managers, and other beneficial owners of securities. Today the CCGG serves as a leading industry monitor and promoter for effective governance practices in Canada for the purposes of create value for its shareholders and stable and reliable earnings streams for their investors.

CICA[62] **–** The Canadian Institute for Chartered Accountants (CICA) in partnership with the provincial and territorial institutes oversees the functions that are critical to the success to the Canadian Chartered Accountancy profession. Its mandate is to ensure that its members (including organizations and individual chartered accountants) act in the public interest by adhering to high professional standards and ethical practices.

Contingency[63] **Theory** – Contingency Theory is a management behavioural theory that suggests that the best way to organize and run a company or organizations is dependent (contingent) on the situation that the organization finds itself operating within, both internally as well as externally.

Corporate Governance[64] – Corporate Governance is the framework of rules and practices by which a board of directors ensures accountability, fairness, and transparency in a company's relationship with its all stakeholders. Corporate governance also helps ensure that principals and agents are behaving in a fashion consistent with local legal requirements and the objectives of the owners, shareholders and beneficiaries. Every element of an organization, including international subsidiaries, falls under the jurisdiction of corporate governance.

GLOCAL[65] **-** A *glocal* company is a transnational firm that simultaneously demonstrates a global orientation towards shareholders (the parent company needs) as well as a local orientation (stakeholders of the local company). The result is GLO-bal effectiveness and lo-CAL responsiveness (glo-cal).

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[61] See: www.ccgg.ca/
[62] See: www.cica.ca/
[63] Barney, J.B. (1985). Dimensions of Informal Social Network Structure: Toward a Contingency Theory of Informal Relations in Organizations, *Social Networks, 7*, 1-46.
[64] Business Dictionary – See: www.businessdictionary.com/definition/corporate-governance.html
[65] Hilb, "Glocal Management of Human Resources" – page 11

"Good Corporate Governance" – The term "good corporate governance" or "good governance" is referenced to in this dissertation as the ideal state in organizations that includes systems, processes and policies that produces effective governance results yet still allows needed flexibility and freedom for innovation and business success.

ICD[66] - The Institute of Corporate Directors (ICD) is dedicated to fostering excellence in board directors and to strengthen the governance and performance of Canadian corporations and organizations. The ICD delivers on this mission through education, certification and advocacy of best practices in governance in Canada.

International Subsidiary – An International Subsidiary is a fully owned and run legal entity, branch, representative office or other business structure of a company that operates in a foreign international jurisdiction. International subsidiaries often have to comply with the laws of both the host jurisdiction of its particular location as well as the home jurisdiction of the corporate parent.

IoD[67] – The Institute of Directors (IoD) was formed in 1906, in London, England to promote high levels of skill, knowledge, professional competence and integrity on the part of directors, and others for the purposes of good governance practices among companies and organizations. It fulfills its mission through education and research in the practices of corporate governance. In addition to promoting dialogue and producing various publications, the IoD has also been instrumental in establishing similar institutes in numerous countries around the world.

OECD[68] - Organization for Economic Co-operation and Development is an international body of 30 countries that has been created to provide a forum for discussion, debate and co-operation on matters of economic and social interest to these countries and the world. In 1999 the OECD launched the "Principles of Corporate Governance" which is generally regarded as the first global initiative to instill best practices in Companies and organizations.

Office of the Superintendent of Financial Institutions – see: OSFI[69]

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[66] See: www.icd.ca/
[67] See: www.iod.com/
[68] See: www.oecd.org/
[69] See: www.osfi-bsif.gc.ca/

OSFI – the Office of the Superintendent of Financial Institutions, Canada's national regulator of Banks and Insurance companies and other financial institutions

Ponzi Scheme[70] - A Ponzi Scheme is a fraudulent investment operation named in 1910 after Charles Ponzi, an individual who defrauded investors in a pyramid-type operation that promises high rates of return with little risk to investors. The Ponzi scheme generates returns for older investors by acquiring new investors. These schemes usually collapse on themselves when the new investments stop.

Rogue Trader[71] **–** a Rogue Trader is an employee who transacts business deals or trades that they are not authorized to perform. Rogue trading is usually associated with banks or other securities or financial services firms where securities and other financial instruments are bought and sold for the benefit of the company or client investors.

Sarbanes-Oxley (SOX)[72] - The Sarbanes-Oxley Act, enacted in July 2002 by US Senator Paul Sarbanes and US Congressman Michael Oxley, developed in response to numerous US corporate and accounting scandals (such as Enron, Tyco International, and WorldCom).

Stewardship Theory[73] – Stewardship Theory is a management theory that suggests that managers will on their own initiative act as stewards in their organizations dutifully overseeing and managing the business, the employees and other assets placed in their care.

Subsidiary - The term Subsidiary for this paper includes all formal (legal) subsidiaries, and for our purposes also encompasses branches, special purpose vehicles or entities (SPVs or SPEs), representative offices as well as fully incorporated (subsidiary) entities. Joint Ventures would not be included.

Subsidiary Governance – Subsidiary Governance is the extension of corporate governance processes and policies that guide a subsidiary, its board and its operations to "Good Corporate Governance" (see definition) within a multinational organization.

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[70] Investopedia – See: www.investopedia.com/terms/p/ponzischeme.asp
[71] Investopedia – See: www.investopedia.com/terms/r/roguetrader.asp
[72] Sarbanes Oxley Act (002) – See: www.soxlaw.com
[73] Clarke, T., *"Theories of Corporate Governance",* Routlrdge, USA (2004), pp 122-123

Subsidiary governance encompasses the presence and application of controls as well as guidance on corporate secretarial processes and policies. This term would include standards for subsidiary board make-up, subsidiary board minutes and meetings, and the specifications for the delivery of board duties.

TSX[74] – The Toronto Stock Exchange (formerly known as the TSE before 2002) is the largest stock exchange in Canada located in Toronto, Ontario. It is owned by and operated as a subsidiary of the TMX Group for the trading of senior equities. One of the many criteria for maintaining a company's stock on the TSX is adherence to the TSX's strict trading and disclosure rules

WEF[75] – The World Economic Forum (WEF) is an international organization whose membership includes one thousand global enterprises who seek sustainable and global solutions to improve the state of the world. Members are typically global enterprises who rank among the top companies within their industry and/or countries. The WEF pursues its mission through discussion, research and education and produces many global publications on the state countries. Of great importance to this research is the WEF's "The Global Competitiveness Report 2011-2012".

Wells Notices[76] – A Wells Notice is a letter that the U.S. Securities and Exchange Commission (SEC) sends to people or firms when it is planning to bring an enforcement action against them. The Wells Notice indicates that the SEC staff has determined it may bring a civil action against a person or firm.

White-Collar Crime[77] – White Collar Crime is a non-violent crime that is committed by someone, typically for financial gain. The typical white-collar criminal is an office worker, business manager, fund manager or executive and includes the corrupt business practices of individuals in executive positions that result in the attempt or execution of a crime, fraud, or other abuse, directly as a result of misusing their power.

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[74] See: www.tmx.com/
[75] World Economic Forum – "The Global Competitiveness Report 2011-2012", pg. 140
[76] See: en.wikipedia.org/wiki/Wells_notice
[77] See: www.investopedia.com/terms/w/white-collar-crime.asp

Part II: General Theoretical Section

Framework Development – "New Corporate Governance" for International Subsidiaries

2.1 Historic Development of Corporate Governance:

While the term corporate governance has only come into common use generally in the past twenty years, it has become an active and daily pursuit for organizations during the last decade. Now the term is commonly used in legislation, regulation, job titles, books, and academic research journals. The scope of governance has also expanded beyond businesses alone and is now regularly applied to all types of organizations, including government, charity, medical and academic.

The reason we have seen an accelerated attention toward corporate governance in particular is a direct result of the shocking scandals that plagued businesses since the late 1990s. At its most general level, corporate governance has come to represent how an organization is run, or governed, and it is especially concerned with corporate accountability, oversight, ethics, integrity, and risk management. It consists of the formalized set of processes, policies and authorities that collectively direct the way people manage, administer or control a corporation. Corporate governance also addresses the relationships between the agents of the corporation and the corporation itself. The key figures in corporate governance were originally only considered to be the shareholders, management, and the board of directors. Today, in contrast, other stakeholders like employees, suppliers, customers, banks, regulators, the environment and the community at large are recognized to have strong and direct interests in how an organization performs. Indeed, as we have seen from previous examples of financial scandal, it is these secondary stakeholders who are often the most severely affected by breaches of corporate governance.

The term *corporate governance* is generally attributed to Richard Eells[78] in his 1960 book "The Meaning of Modern Business: An Introduction to the Philosophy of Large Corporate Enterprise". In this seminal work Eells explores the responsibility corporations and their management have to an audience of stakeholders that extends

[78] Eells, R. (1960), "The Meaning of Modern Business: An Introduction to the Philosophy of Large Corporate Enterprise", New York: Columbia University Press

beyond the immediate owners. He coined the phrase "corporate governance" to denote "the structure and functioning of the corporate polity".

A lawyer named Adolf Berle (1895–1971) was one of the first authors to expand the notion of governance to include both legal and economic aspects. His book, *The Modern Corporation and Private Property*,2 which was co-written with economist Gardiner Mean, describes the ascendancy of professional management and the creation of the so-called agency problem. The agency problem occurs because management, in the absence of a countervailing power, has a tendency to pursue their own self-interest at the expense of the corporation. With uncanny insight into the types of fraud that would shake the world some 60 years later, Berle and Means warned that the growth of large corporations and the emergence of professional managers could lead to unchecked corporate power and serious economic consequences. They subsequently advocated for regulations curbing corporate power in the United States. Berle promoted the need for management to serve as responsible stewards of society and not simply seek to maximize shareholder wealth. But recognizing that even management can be actors in the agency problem it was Daily et al.3 in 1994 who identified the board as the central internal governance body.

While regulators and legislators may be pleased with how much corporate governance has evolved in such a short period of time relative to laws, behaviours and organizational changes, what is truly disconcerting are the wanton frauds, executive criminal activity, rogue trading and other crises of governance that have equally occurred is such a short period of time. The widespread and devastating effects of these breaches was made apparent in Section 1.1.1 (Research Problem), despite the fact that the examples cited there only included situations involving international subsidiaries. Two points are important to note in this regard: first, each breach of corporate governance I detailed occurred in the last 16 years; second, the regulations and controls put in place as a result still did not prevent subsequent failures, including the 2008 banking crisis that drove the largest global recession since the Great Depression. These new regulatory requirements may have done a great deal of good and they may have contained or diminished the total amount of corporate governance issues but it is clear that they did not entirely prevent breaches in corporate governance.

Although the global wave of corporate governance spread almost universally around the world—particularly after the OECD first issued their Principles of Corporate

Governance in 1999—reviewing the history of corporate governance highlights the need to recognize the key contributions made by individual countries. Appendix A chronicles the historic timeline of changes in governance regulations and contributions across the world. I will first examine the British contribution, followed by the contributions made by South Africa and Canada, and then discuss how these changes in governance globally affected the behaviour of organizations and regulators around the world.

2.1.1 The British Contribution:

The contribution made by Great Britain to the body of work, thought and recommendations affecting corporate governance has been tremendous. The Cadbury Report[79] in 1992 is generally recognized as being the first comprehensive publication to recommend direct changes in the practices of corporate governance. However, British contributions to improving board effectiveness can actually be traced back to the British Accounting Standards and Steering Committee, whose 1975 Corporate Report focused attention and responsibility on corporate directors. Subsequently, Sir Brandon Rhys Williams5 published a Green Paper in 1977 for the UK Parliament, entitled The Conduct of Company Directors, which, for the first time, called for the independence of board directors and the use of Audit Committees. While this motion did not pass Parliament, the stage had been set for future considerations that would ultimately lead to changes in board makeup and the concept of board committees.

In the UK, the decade of the 1980s also played an important role in the evolution of corporate governance. The government of Margaret Thatcher focused on privatization, which championed a movement toward shareholder value and increasing the government's treasury. This required a cultural shift from state-owned to profit-driven companies, a movement that was consistent with the politics and initiatives of Ronald Regan in the United States at that time. The focus on governance was less of a priority. This led to the decade of the 1990s, when the pendulum swung emphatically in the other direction and governance became the key priority for the UK.

[79] Cadbury Report - "The Financial Aspects of Corporate Governance": http://www.ecgi.org/codes/documents/cadbury.pdf

The Cadbury Report

The Cadbury Report[80] of 1992 is generally acknowledged as a critical initial contribution that began an accelerated interest in corporate governance. Sir Adrian Cadbury was asked by a group consisting of the Financial Reporting Council, the London Stock Exchange, and the accountancy profession to establish a committee to investigate corporate governance systems in England. The timing of this request followed an increasing raft of corporate scandals, the most famous of which read like a suspense thriller: it, involved a flamboyant businessman who defrauded his company of nearly $1billion US and whose life ended suddenly and mysteriously. It was suitably dubbed the Maxwell Affair.

Robert Maxwell, the head of Maxwell Communications, had overburdened his company with debt as a result of an aggressive series of acquisitions in the late 1980s. In 1990 he died mysteriously while cruising in the Canary Islands. His company's books were thrown open as a result and it was found that Maxwell had defrauded the company's pension plan of £440 million to prevent the company from going into bankruptcy.

Close on the heels of the Maxwell Affair, The Bank of Credit and Commerce International (BCCI) went bankrupt in 1991 and lost billions of dollars for its depositors, shareholders and employees. The ensuing investigation discovered that this bank had been active in money laundering and other illicit financial activities and was found to be acting as personal banker for corrupt politicians and dictators such as Saddam Hussein and Manuel Noriega.

Cadbury and his Committee focused on the financial aspects of corporate governance and developed a code of best practice directed toward corporate self-regulation. The Cadbury Code, as it came to be known, established standards of corporate behaviour and ethics and was subsequently adopted by the London Stock Exchange as the benchmark of good boardroom practice for all listed companies. These best practices included the composition of boards of directors and the appointment of independent, nonexecutive directors and service contracts. It also specified that the remuneration of executive directors should be directed by a formal Remuneration Committee comprised primarily of nonexecutive directors, provided guidelines 60

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[80] Cadbury Report, ibid

surrounding a company's financial statements, and required the creation of an Audit Committee comprised of at least three nonexecutive directors.

These recommendations were implemented first in Britain and shortly thereafter incorporated into legislation in the European Union, the United States, the World Bank and other leading organizations and countries. They effectively became the starting framework for the OECD and for the laws that followed it in 1999, three years after the shocking collapse of Baring Brothers. In essence, the Cadbury Report established the first standard methodology that regulators would follow as they wrestled with the new challenges of corporate governance.

The Greenbury Report, the Combined Code, "The Code" and the Stewardship Report

The Cadbury Report was followed in 1995 by a study on executive compensation led by Sir Richard Greenbury. His report, which came to be known as the Greenbury Report, recommended that company boards institute a remuneration committee to oversee executive compensation. It also suggested that board directors should have long-term, incentive-based compensation in order to align themselves with company performance. Greenbury recommended a review in three years' time. In 1998, Sir Richard Hampel chaired the follow-up committee and recommended that chairs of boards should be nonexecutive directors. His review of remuneration concluded that this subject needed to be expanded to include pensions and other forms of compensation. In addition, Hampel's report suggested that the Cadbury Report (on corporate governance) and the Greenbury Report (on executive compensation) should be merged to create a single set of governance principles. The merger of these reports came to be known as the Combined Code. The Combined Code was another breakthrough in corporate governance because it recognized both the need for board dynamics as well as the bond between executive compensation and long-term performance. As Hilb points out this was seen as best practice in soft law6 for emulation by other countries and their regulators. In 2009 the Financial Reporting Council (FRC) conducted a further consultation on the Combined Code and made several additional changes. These included the annual reelection of directors for FTSE 350 companies, the introduction of an externally facilitated board evaluation process every three years, and an alignment of performance-related compensation to long-term company success. The FRC also recommended that these changes be added to the existing Combined Code, which as a result became known as the UK Corporate

Governance Code or simply the Code. These refinements were implemented in June 2010 and the Code became effective on that date.

The contribution that Great Britain was making in the field of corporate governance was gathering momentum.

Cadbury Code and the OECD

As discussed previously, a senior trader for Barings Bank in Singapore, Nick Leeson, in 1996 reduced the market value of his venerable 233-year-old English bank from roughly £400 million to £1 via unauthorized "rogue" trading losses of £827 million. Coming shortly after the Maxwell scandal, the Barings failure rattled organizations across the globe and both regulators and governments knew they had to take action. The OECD also took up the challenge by incorporating the "Cadbury Code" into their Principles of Corporate Governance in 1999. However, the OECD's set of recommendations was not about self-regulation as Cadbury had done, but rather was targeting law makers around the world. We discuss the OECD Principles in further detail in Section 2.1.4 "Global Guidelines".

Higgs Review

The next major milestone in the British contribution to corporate governance occurred in November 2003, with the implementation of recommendations emanating from the Higgs Review[81]. In April 2002, Derek Higgs was appointed by the British government to head a review on the role and effectiveness of nonexecutive directors. This review was launched shortly after the United States experienced several high-profile scandals (such as Enron, WorldCom, and Tyco) that were believed to be caused by poor corporate governance practices. The United States responded by launching the Sarbanes-Oxley review and developing new legislation in NYSE listing rules in mid-2002. The UK government, although somewhat removed from the full effects of these scandals, felt an urgency to examine their own current practices. The Higgs' mandate was subsequently to review nonexecutive directors and, in particular, examine their degree of independence, their effectiveness, and accountability, and review issues such as remuneration. The goal was to then make recommendations and strengthen the effectiveness of nonexecutive directors.

[81] Jones, I. – "Understanding How Issues in Corporate Governance Develop" – Centre for Business Research, University of Cambridge Working Paper No. 277

Many of Higgs' recommendations were controversial for their time causing debates in the industry. In October 2003, many of Higgs' recommendations were incorporated into the UK's Combined Code. The revised Code now addressed issues of board structure, the role of the chair, non-executive directors, audit and remuneration committees, recruitment and professional development initiatives for board directors, and relationships with shareholders. The Combined Code on Corporate Governance was initiated in 1992 with the Cadbury Report and eventually replaced by "The UK Corporate Governance Code" in 2010[82]. The Code targeted companies listed on UK stock exchanges and required them to follow the Financial Services Authority's listing rules. These listing rules carry statutory authority under the Financial Services Market Act of 2000.

As we know today, the focus, role and importance of independent non-executive directors has flourished in legislation and regulation around the world. This was directly caused by the Higgs Review and clearly demonstrates the key role Britain played in the development of corporate governance practices and laws.

The Walker Review

In 2008 Britain saw the first run on a British bank in 150 years with the collapse of Northern Rock[83]. This collapse came as a result of the 2007-2008 global financial crisis[84] that began in the United States and quickly spread around the world to other banks and treasuries. In Great Britain, the Prime Minister appointed Sir David Walker to work with the Financial Reporting Council (FRC) and the Financial Services Authority (FSA). Walker was to review the UK banking industry and make recommendations that could be applied to banks and other UK companies regarding their board and governance practices. What came to be known as "The Walker Review"[85] commenced its work by examining the effectiveness of risk management, the skill-sets of boards, and the level of independence of directors in UK financial institutions. It also analyzed the effectiveness of audit, risk and remuneration committees and reviewed how UK practices compared internationally. The final report

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[82] "The UK Corporate Governance Code" – UK Financial Reporting Council, June 2010
[83] The National Archives, HM Treasury - http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/5722.htm
[84] Pozen, R, "Too Big to Save – How to Fix the US Banking System" – John Wiley and Sons, 2010 p. 3
[85] The National Archives, HM Treasury - http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/walker_review_information.htm

was issued in 2009[86] and concluded by making detailed recommendations including: what constituted effective board size; board composition; qualification of board directors and the chairman; board director training and development; and how boards need to function to be effective. The Report also delved in depth with "governance of risk" including the need to identify a risk strategy, the identification of risk tolerances and appetite, the independence of the risk function and the role of the Board's risk committee. Many of the suggestions were clearly breakthroughs for the financial sector and governance regulators around the world.

Sir David Walker would be called upon again by the British Prime Minister and the FSA in 2011. This time he would work with Bill Knight and examine the failure of the Royal Bank of Scotland. The FSA's subsequent report to its board in December of 2011[87] outlined the regulatory and supervisory activities that occurred just prior to the failure of the bank.

Governance as an Industry in Britain

With Britain taking a global leadership role for corporate governance since the early 1990s, it is not surprising that other industry organizations, associations and consultancy firms also emerged in Britain. The International Corporate Governance Network (ICGN) was formed in 1995 and today has evolved into "a global membership organization of over 500 leaders in corporate governance in 50 countries, with institutional investors representing assets under management of around $18 trillion"[88]. In addition to publishing various reports, discussion papers and surveys, the ICGN publishes best practice guidance and assists member firms as they progress change in their markets and institutions. In keeping with both global best practices and local market needs, the ICGN monitors progress in all member markets and is a global leader with their publication "ICGN Corporate Governance Principles"[89].

In addition to the growth of industry associations and watchdogs in the UK, a number of consulting organizations have arisen to assist companies and their boards

[86] The Walker Review - http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf
[87] FSA Report – "The Failure of the Royal Bank of Scotland: Financial Services Authority Board Report" Dec 12, 2011 http://www.fsa.gov.uk/library/other_publications/miscellaneous/2011/rbs.shtml
[88] The International Corporate Governance Network – can be found at: http://www.icgn.org/about.php
[89] "ICGN Corporate Governance Principles: Revised (2009)" - http://www.icgn.org/files/icgn_main/pdfs/best_practice/global_principles/short_version_-_icgn_global_corporate_governance_principles-_revised_2009.pdf

implement change. One such firm is Nestor Advisors.[90] Nestor Advisors originated in London as board and company consultants in 2003 shortly after the OECD released their updated "Principles of Corporate Governance". Today this governance consulting firm is globally known for their specialization in bank boards of directors and for their regular contribution to Basel proposals and other governance reviews. The Nestor Advisors' most recent publication reviewed the top 25 banks in Europe with regard to their board dynamics and processes. These reports are read extensively around the world and serve as a useful contribution for national regulators and governance consultants, as well as for board chairmen and others interested in the evolution and innovation of corporate governance.

Stewardship Code

Also in 2010, the Financial Reporting Council issued a new set of principles aimed at institutional investors and other fund managers that act on behalf of listed companies in the United Kingdom. These new principles introduced the need for "stewardship" by requiring institutional and fund managers to be actively engaged in the governance of the companies whose stock their clients owned. Distinct from the Code of the same year, the "Stewardship Code"[91] extended the need for governance oversight, not only to Boards and directors, but now also to intermediaries with oversight obligations for their investors. This was the first such instance where governance guidelines were extended in this manner and it serves as another breakthrough contribution from Britain.

Institute of Directors (IoD)

Also making a contribution to the world in corporate governance is the London based Institute of Directors. Not only have they contributed to and followed these various evolutions of governance in Britain but they have also been "Internationally the biggest influence on the guidelines"19 by providing advice to other nations who seek insight to best practices that Britain has developed over the past two decades.

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[90] Nestor Advisors – "Bank Boards and the Financial Crisis – A Corporate Governance Study of the 25 largest European Bank", May 2009
[91] Financial Reporting Council – "The UK Stewardship Code" – July 2010

2.1.2 South African Contribution:

After the release of the Cadbury Report, countries around the world reflected on their own need to institute changes to the practices and processes of corporate governance pertaining to listed corporations in their jurisdiction. As Britain started to incorporate the Cadbury Code, other countries actively started to examine their existing corporate laws, stock exchanges, securities legislation, as well as banking and other regulated industries to see if changes were needed in their corporate governance practices. Very few countries were playing a leading role in governance as we have seen in Britain. South Africa had been following a traditional trajectory in its own evolution but in 1994 this country made a highly significant contribution of "soft law"[92] to the world of governance with the so-called "King Report on Corporate Governance" (King I - 1994; King II - 2002. King III 2009). Consistent with Hilb's "New Corporate Governance" framework,[93] the King reports introduced an expanded scope for corporate governance that was holistic in its approach and inclusive of broader stakeholder groups such as employees, customers and the public.

King I

In 1993 the South African Institute of Directors (IOD) formed what came to be known as the King Committee on Corporate Governance under the leadership of retired Supreme Court of South Africa judge Mervyn E. King. The King Committee emerged shortly after the release of the Cadbury Report in Britain and was designed to examine international corporate governance initiatives occurring at that time and make recommendations that would be appropriate for South Africa. The first report was called the King Report 1994 and it initiated the institutionalization of corporate governance in South Africa. Recommendations targeted listed companies of the Johannesburg Stock Exchange as well as financial institutions. The Report included standards of conduct for directors and boards. But importantly, King went beyond the traditional *share*holder focus, by taking a wider approach and advocated governance that accounted for *stake*holder interests and encouraged not only good financial practices but good social, ethical, and environmental practices[94] as well. This holistic focus became a recurring theme in subsequent King Reports and represents a unique contribution from South Africa to the world of corporate governance.

[92] Ibid, p 65
[93] Ibid, pp 10-11
[94] Ibid, p 24

King II[95]

By 2002 much had changed in the world – the OECD Principles of Corporate Governance had been issued, Enron, WorldCom and Tyco had failed, and research was being conducted by Sarbanes and Oxley in the United States. The King Committee was subsequently requested to update their 1994 work to see what additional changes were necessary for South Africa in these more current times. The second King Report on Corporate Governance came to be simply known as King II. In addition to numerous recommendations, this report contained a Code of Practices and Conduct and provided a framework of good corporate governance that included seven characteristics:

- Discipline – demonstrating behaviours that are acceptable and correct
- Transparency – providing information that allows easy analysis of company positions
- Independence – deliberately structuring boards to avoid conflicts
- Accountability – ensuring proper accountability
- Responsibility – acting responsibly toward all stakeholders
- Fairness – demonstrating good judgment and ensuring conflicting issues are balanced
- Social Responsibility – taking ownership for being a positive member of society

King II expanded on the needs of stakeholders[96] and introduced for the first time the requirement for stability of the corporation by actively planning for sustainability within corporations. The focus of sustainability underscores the wider stakeholder audience that corporations clearly affect and expands governance beyond the simple focus on shareholders as the only relevant party.

King II also makes specific reference to a board's obligation to all stakeholders and in devotes an entire section to the various ways that "social responsibility" is a crucial component of corporate governance. King II also has special importance for our research on corporate governance of international subsidiaries. As Hilb[97] points out

[95] Institute of Directors of Southern Africa – "King Report of Corporate Governance for South Africa 2002". Parktown, South Africa
[96] Institute of Directors of Southern Africa - "Executive Summary of the King Report 2002". Parktown, South Africa
[97] Hilb, p 33

"transnational firms would benefit from the development of *glocal* rules of integrity" following "the thoughts on world-ethics from Kueng (2001) and the "King II" report".

Of the three reports issued by the King Committee on Corporate Governance, it was King II that affected global thinking and expanded the scope of corporate governance to a new dimension.

King III

The King Committee was reconvened yet again in 2009 and it once again furthered the responsibility of corporations towards their larger stakeholder audience. The King III recommendations addressed corporate citizenship, compliance with laws, and the governance of stakeholder relationships. The theme of sustainability was also expanded through the recommendation that companies produce an annual sustainability report. This is largely seen as the most important contribution of the King III report.

In 2010 the Johannesburg Stock Exchange made the King III recommendations mandatory for all companies listed on it. Through the production of the third installment of the King Committee, South Africa was again leading the world in promoting the rights and needs of a broader stakeholder group as a component of a comprehensive corporate governance strategy.

2.1.3 Canadian Contribution:

Canada has historically rated well in various international rankings. In the United Nations' "Human Development Index" Canada has been listed as high as #1 (1996) and in 2011[98] was ranked as #6. In the World Economic Forum's "Global Competitiveness Report 2011-2012"[99] Canada was ranked as #12 overall and #1 in "Soundness of Banks" for the 5th consecutive year. As a country it has the second largest land mass in the world and is rich in natural resources. Coupled with a strong historic connection to Great Britain and influences from its closest neighbor, the United States, Canada demonstrates a unique blend of British conservative values and sense of fair play yet with a modern and innovative culture. It is no surprise then that Canada has been at the forefront of developments in corporate governance.

[98] United Nations, "Human Development Report 2011 – Sustainability and Equity – A Better Future for All", p 17
[99] World Economic Forum – "The Global Competitiveness Report 2011-2012" pp 140-141

As the Cadbury Report was being absorbed around the world, the Toronto Stock Exchange (TSX formerly known as the "TSE" before 2002) launched its own review of corporate governance practices in 1993. Under the leadership of by Peter Dey,[100] a former chairman of the Toronto Stock Exchange, the TSE published a landmark study in 1994 on corporate governance for listed companies across Canada. It focused on shareholder value and made fourteen recommendations for best practice governance guidelines for companies and their boards. Although the recommendations did not become law, the TSE required listed companies to annually disclose whether they were in compliance with these new standards and if not, to explain to the TSE why they were not in compliance. This had a similar effect as law.

The recommendations made by the Dey Report introduced definitions and roles for unrelated directors as well as non-management directors. It proposed a number of new requirements for boards, including an annual evaluation process, directors education programs, assessments of directors, the independence of the Audit Committee, the introduction of a Governance Committee, the need for independence of the Chair, the need to ensure that director compensation is aligned with director responsibility, the creation of a Nominations Committee and the need for position descriptions for the board and the CEO with defined limits to management's responsibilities.

The Dey report had wide ranging effects on listed companies in Canada. The report also recommended that a follow-up review be conducted five years later and under the joint sponsorship of the TSE and the Institute of Directors (ICD), a survey was issued to 1250 CEOs of TSE listed companies. It sought to identify the extent to which corporate governance in these public companies reflected the TSE guidelines that came from the Dey Report. Entitled "Corporate Governance, 1999 - Five Years to *the Dey*",[101] the survey (See Table 2) concluded that decent progress had been made on key governance attributes like board size, role, composition, independence and control mechanisms. It also noted little progress on accessing board and director effectiveness, creating position descriptions, and meeting independently of management.

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[100] Dey, P. – "Where were the Directors" Toronto Stock Exchange (TSE) Committee on Corporate Governance, Dec 1994

[101] Institute of Corporate Directors & Toronto Stock Exchange – "Report on Corporate Governance, 1999 – Five Years to the Dey", p 1

The TSE/ICD survey determined that while most corporations did in fact take the TSE guidelines seriously, it noted that "one size did not fit all"[102] when it comes to corporate governance. On one hand it was determined that many of the largest companies were in fact leaders in corporate governance strategy and practices. On the other hand, it noted that smaller companies complained that "corporate governance requirements can be overly burdensome for smaller companies. The problems related to the board of a chartered bank are quite difference for an intermediate mining company"[103]. So while most companies took the guidelines seriously, it was now being understood that corporate governance practices needed to be relevant for the industry and the size of company. This would be an important observation in future reviews and discussions of corporate governance in Canada.

Table 2 – Toronto Stock Exchange Scorecard - 1999

TSE Guideline Scorecard	% Adoption
Board size suitable for individual accountability	95%
Strategic planning involvement	79%
Board constituted with majority of unrelated directors	77%
Internal controls and management information systems	76%
Satisfactory compensation to directors	76%
Independence: Non-CEO Chair or lead director	69%
Only non-management members on nominating committee (for those with nominating committees)	68%
Risk management systems in place	60%
Orientation for new directors	49%
Explicit attention to governance	48%
Position descriptions and objectives for CEO	48%
Independence: Known procedure by which directors can retain outside advisors	39%
Separate nominating committee	33%
Succession planning for senior management	28%
Communications policy	25%
Process for assessing director effectiveness, other than ad hoc discussions with chair	24%
Independence: Board meets occasionally without management present	21%
Position descriptions for directors	18%
Process for assessing board effectiveness	18%

(Source: "Corporate Governance 1999, Five Years to the Dey"[104] - TSE)

102 Ibid, p 4
103 Ibid
104 Ibid, p 3

Corporate Governance - Standing Committee on Banking Trade & Commerce[105]

Also worthy of note was a little known report drafted by the Senate of Canada in 1996, under the request of then Industry Minister, John Manley. He requested that hearings be conducted with senior business people and investors for the purpose of updating the Canada Business Corporations Act (CBCA) in areas of corporate governance. The issues that came out of that review included the need for liability of corporate directors, corporate auditors and others associated with a corporation; the need for guidelines on compensation and other financial assistance to directors from a corporation; insider trading rules; the need for improved communications to shareholders; and requirements regarding the citizenship and residency of directors. In addition to these recommendations, the Committee suggested that the CEO and the board chair roles should be separated for all companies regulated by the CBCA. Although these were simply recommendations at the time, the discussions that centred on the increase of liability and the role of directors were now reaching the highest powers in the land; they would in fact be enacted as law shortly after the OECD principles were released in 1999.

Bill S-11: Canada & the OECD's "Principles for Corporate Governance" in 1999

As a founding member of the Organizational Cooperation and Development (OECD), Canada has historically played a leading role in global issues. In 1998 Canada was active at the OECD in developing the Principles of Corporate Governance. As a result, it is no surprise that Canada showed itself to be a leader in corporate governance by being one of the first countries in the world to introduce the OECD Principles as law in February 2001 with Bill S-11, "An Act to Amend the Canada Business Corporations Act and the Canada Cooperatives Act and to Amend Other Acts"[106]. Enacted into law in June 2001, Bill S-11 among other things introduced liability of directors for proper supervision of management. It defined the role of insiders with more precision and introduced share trading restrictions. It also detailed numerous shareholder rights and the obligations of directors to ensure transparency reporting. Importantly, these laws affected all corporations and industries that were regulated by the Canada Business Corporations Act, regardless of size, and became Canada's most

[105] Parliament of Canada – "Corporate Governance - The Standing Senate Committee on Banking, Trade and Commerce", Aug 1996

[106] Parliament of Canada – "Bill S-11: An Act to amend the Canada Business Corporations Act (LS-389E)", June 2001

widely followed piece of federally incorporated legislation. As a result of the OECD principles, financial and civil liabilities were now in effect in Canada.

Kirby Report[107] – "The Governance Practices of Institutional Investors" – 1998

Adding another material contribution to the discussion on corporate governance in Canada is the Kirby Report of 1998. Chaired by Senator Michael J. Kirby, the focus of this committee's attention was the review of governance practices of institutional investors. This interestingly also included and examination of pension plan boards and other institutional investors who hold a fiduciary obligation for governance on behalf of beneficial stock owners. While not as expansive as the King I and King II reports (and without the benefit of directly affecting new laws in Canada) the Kirby Report also addressed the need to extend the reach of governance to more than just direct shareholders. Kirby also championed the need for best practices to be in place and, like the King I Report in South Africa, expanded the definition of corporate governance to include all relevant stakeholders. The Kirby Report was re-examined in 2002 by the Canadian Securities Administrators35 as they prepared proposals for governance of mutual funds and for the conduct of their employees.

Saucier Report[108] – "Beyond Compliance: Building a Governance Culture – 2001

A successor to the Dey Committee was formed in 2000 and entitled "The Joint Committee on Corporate Governance". Led by Guylaine Saucier, a former Chair of the Canadian Institute of Chartered Accountants (CICA), this report was published in November of 2001 and came to be known as the Saucier Report. The committee was cosponsored by the TSE and the CICA and was mandated to review the current appropriateness of the TSE guidelines that resulted from the Dey Report. In this follow-up review, Saucier and her committee sought to encourage the development of a healthy corporate governance culture that would allow management and directors to work together in an atmosphere of mutual respect and understanding. For the first time in Canadian corporate governance history the introduction of soft controls such as culture were being discussed, a topic that will bear further review as our research unfolds.

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[107] The Standing Committee on Banking, Trade and Commerce, Government of Canada, "The Governance Practices of Institutional Investors," (The Kirby Report), Ottawa: Government of Canada, November 1998, http://www.parl.gc.ca/36/1/parlbus/commbus/senate/com-e/bank-e/rep-e/rep16nov98-e.htm.

[108] Chartered Accountants of Canada and TSE – Joint Committee on Corporate Governance – Nov 2001

Also included in the Saucier Report were the recommendation to hold formal reviews of the CEO's performance, the need for an annual assessment of a board's effectiveness, and the need to hold regular meetings of independent board members without management present (in-camera sessions). The report also focused on the audit committee and recommended that it should be completely independent of directors, who are financially literate, and include at least one director holding a formal accounting designation. The Saucier Report also suggested that audit committees should have a formally crafted mandate of responsibilities that are approved by the board. The Saucier Report also turned its attention to general management by ensuring that managers had appropriate practices for risk assessment, risk management and controls in place.

The Saucier Report was formally entitled "Beyond Compliance – Building a Governance Culture" and was published in November 2001. The recommendations were implemented into the TSE's regulations for all listed companies. The fact that attention was being focused on risk assessments and controls in this report marked another first in Canada's corporate governance practices.

Canadian Coalition for Good Governance[109] - 2003

Founded in 2003, the Canadian Coalition for Good Governance (CCGG) is a not-for-profit corporation that represents the interests of institutional shareholders. The CCGG was formed by institutional investors to promote effective governance practices in companies whose members include pension plans, mutual fund investors, third-party money managers, and other beneficial owners of securities. The CCGG's members believe that effective governance practices contribute to a company's ability to create value for its shareholders and in turn provide more stable and reliable earnings streams for their investors.

Through its promotion of good governance practices in Canada, the CCGG successfully advocated for the splitting of the roles between CEO and Chair[110] in Canada's banks, as well as other improvements in public companies. Its mission is to improve the regulatory environment to better align the interests of boards and management with shareholders. In part III of this book, further references to the

[109] Canadian Coalition for Good Governance – "2011 Best Practices", pg 1
[110] Interview –David Beatty (board Director, Bank of Montreal and Managing Director of the Canadian Coalition for Good Governance), May 26, 2011

impact that the CCGG has had on the evolution and development of governance practices in Canada (lobbying for change, industry watchdog, plurality voting) are provided.

Industry Watchdogs

Canada's progression toward improved governance standards may appear to have been led by conscientious securities regulators, accounting associations, and the government. However, there were several grassroots individuals and organizations that were actively advocating for change and monitoring the progress during this formative period. In a report prepared for the Government of Canada in May 2002 by the consulting firm Sussex Circle Inc., Senator Michael J. Kirby pointed to the "gadflies"[111] as playing a critical role in advocating for change and improved governance standards in Canada. These efforts pre-date the creation of the Canadian Coalition for Good Governance. Kirby points to the efforts of: Al Rosen, a former advisor to the Auditor General of Canada William McKenzie, a shareholder rights advocate whose aim was to ensure that institutional investors would "vote their proxies efficiently and intelligently"[112]; Yves Michaud, who founded "L'Association de protection des épargnants et investisseurs du Québec" to defend the interests of Quebec investors directly and through its affiliation with the International Corporate Governance Network; and Richard Findlay, who chaired a Toronto-based think tank called the Centre for Corporate and Public Governance. These "gadflies" provided much of the stimulus that prompted Canada to evolve and become a world leader in corporate governance.

As recommendations and guidelines became law in Canada with the passage of Bill S-11, other advocates and monitoring agencies emerged including the previously mentioned Canadian Coalition for Good Governance. The Clarkson Centre for Business Ethics and Board Effectiveness[113] is another such monitoring agency. In 1988 Max Clarkson (Professor Emeritus at the University of Toronto's Faculty of Management) founded the Centre for Corporate Social Performance and Ethics. The centre was subsequently renamed the Clarkson Centre for Business Ethics and Board Effectiveness (CCBE) to honour its founder. Clarkson, who was a pioneer in Canada for business ethics and stakeholder theory, contributed to international conferences

[111] Kirby, M. – "Corporate Governance and Accountability" – 2002, pp 30-32
http://www.aucc.ca/_pdf/english/programs/cepra/Final%20report_swain.pdf
[112] ibid
[113] The CCBE is discussed further in Section 2.1.5 "Industry Guidelines – Monitoring Industry Change".

and discussions in the formative days of governance development around the world. During its first decade, the CCBE focused on research and publications in the field of business ethics and was active in the development of codes of conduct and ethics that were implemented in many of Canada's largest corporations.
It is interesting to note that just after Maxwell's retirement and over 15 years of promoting ethics in Canada and around the world, the IMD ranked Canadian companies (Garelli – 2003 p. 642)[114] as the best in North America and #6 in the world on its firm-ethics rankings.

In the last decade with the appointment of David Beatty as the Conway Director for the CCBE, the CCBE has broadened its attention to focus on board effectiveness and research in this key area of governance. In support of this new focus and following the laws implemented as a result of the OECD Principles (Bill S-11) in Canada, the CCBE commenced its *Board Shareholder Confidence Index* (BSCI) in 2002 and reviewed the top 250 listed corporations on the S&P/TSX stock exchange in Toronto. In these annual reviews, the CBBE analyzes, quantifies, and presents a report card for companies with regard to their "director independence, board structure, and board output." As they say, "The BSCI has come to set the standard for Canadian corporate governance practices." By drawing attention and publishing its findings relative to good governance, the CCBE has prompted companies to change their structures and improve their reporting effectiveness scores each year. This has clearly improved overall corporate governance behaviours across Canada.

Other monitoring agencies evolved. Canada's leading daily national newspaper, the *Globe and Mail*, launched a board evaluation program in 2002 called *Board Games*. Conducted by Janet McFarland[115] for the past ten years *Board Games* was originally launched after the collapse of Enron and WorldCom, when investors were becoming increasingly worried about activities occurring at publicly listed companies.

Referring to it as a "Quiet revolution"[116] in governance, the *Globe and Mail* reported that significant changes have occurred in the boardrooms of Canada. Most significantly they reported a general shift of power from the CEO to the board of

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[114] Hilb, ibid, p 33
[115] Globe & Mail – "Board Games" - podcast with Janet McFarland: http://www.theglobeandmail.com/report-on-business/careers/management/board-games-2011/podcast-janet-mcfarland-looks-back-on-10-years-of-board-games/article2250610/
[116] Globe & Mail – Board Games: Corporate Canada sees a quiet revolution in governance" - http://www.theglobeandmail.com/report-on-business/careers/management/board-games-2011/board-games-corporate-canada-sees-a-quiet-revolution-in-governance/article2251430/page493/

directors[117]. They also noted an increased interest in and acceptance of report card formats of measurement in Canadian companies. The competitiveness that results from this form of monitoring has resulted in companies making positive changes to their structures. The report card format seemingly drives corporate governance improvements.

Other Contributions from Canada

Canadian companies have generally been viewed well by international observers for following best practices within the Anglo-American board framework[118], as well as in family-owned businesses like the Thompson[119] family in Canada. Canadian companies are also seen to be following governance practices that combine both a culture of both competition (hard) and cooperation (soft) measures. Hilb has called this a blended culture of "coopetition"[120].

The guidelines discussed above clearly place Canada in the league of best practitioners for guidelines.[121] As a country, Canada's unique culture lends itself to both the hard controls of governance as well as the soft controls of culture. We will see later that "culture" is seen by many senior banking executives, regulators and commentators as a key ingredient for success in corporate governance within Canadian banks. And while the World Economic Forum classified Canada as having the most stable banking system in the world[122], much praise can also be given to bank regulators (OSFI, Bank of Canada, Ministry of Finance, etc.) for their efforts at balance and effectiveness.

On November 4, 2011, the Governor of the Bank of Canada, Mark Carney, was appointed Chairman of the Financial Stability Board[123]. This appointment is another kudo for Canada and reflects the FSB's interest in Canada's success emerging from the 2008 financial crisis as well as the "co-opetition" balance of fairness and "steel"[124] that Canada's top banker brings to governance and oversight. Mr. Carney is seen to personify the best of Canada's success in the world of corporate governance. In

117 Globe & Mail – "Board Games" - podcast with Janet McFarland, ibid
118 Hilb, ibid p viii
119 Ibid, p 23
120 Ibid, 25
121 Ibid, p31
122 World Economic Forum – "The Global Competitiveness Report 2011-2012", pg. 140
123 Bank of Canada – Press Release, Nov 4, 2011 http://www.bankofcanada.ca/2011/11/press-releases/bank-of-canada-governor-mark-carney/
124 Financial Times, "Canada's Carney to bring steel to FSB role", November 2, 2011

November 2012, Mr. Carney[125] was appointed Governor of the Bank of England, the first time a non-British national will hold this prestigious post, effective July 2013.

2.1.4 Global Guidelines:

Although a heated debate continues relative to the effectiveness of regulation as a preventative to fraud, there is general agreement that the occurrence of fraud heralds the development of new or increased regulation. As we explore the history of corporate governance we quickly realize the phenomena of "Regulation follows Fraud" (See Appendix 1 **- "**Development of International Corporate Governance").

A. OECD Principles of Corporate Governance[126] - 1999 & 2004

Just as the Cadbury Code followed the Maxwell Affair and BCCI, the next round of fraudulent activity and corporate breaches led to further evolutions in corporate governance through the formulation of new study groups, new legislation and enhanced regulations. In 1998, shortly after the Barings collapse, the Organization for Economic Co-operation and Development[127] (OECD) called for a further study on corporate governance. The OECD Principles of Corporate Governance was released in May 1999 and revisited again in 2003 to recognize governance developments since that time. The OECD hosted extensive consultations using regional corporate governance roundtables. Non-OECD countries were invited to attend so that additional points of view could be obtained. The updated Principles were published and released in April 2004 and are considered to be the most historically influential documents in the development of corporate governance practices and legislation in the world.

In addition to providing a framework for corporate governance and outlining new best practices for corporations and boards, the 2004 Principles introduced new topics to the discussion on governance including: the rights and equitable treatment of shareholders, the role of stakeholders in corporate governance, issues related to disclosure and transparency, and the general responsibilities of the board. It must be

[125] Isfeld, G. (2012) Financial Post Nov 26, "Mark Carney named next head of the Bank of England", See: http://business.financialpost.com/2012/11/26/carney-named-next-head-of-the-bank-of-england/
[126] OECD Principles of Corporate Governance – 2004 can be found at: http://www.oecd.org/dataoecd/32/18/31557724.pdf
[127] The 30 OECD Members are the following: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Norway, New Zealand, Netherlands, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.

noted that the OECD Principles were not issued as binding on member countries. Each member did, however, have the opportunity to review these standards for applicability to their own nation's laws. Within three years over two dozen countries (including those originally outside the OECD's jurisdiction) incorporated the OECD Principles into laws governing corporations. Countries that quickly implemented the 1999 OECD Principles into law included: Canada, the United States and Singapore in 2002, Australia and Germany in 2002, and Brazil (a non-OECD country) in 2004. Today, most Western economies have laws that address corporate governance based upon the combined OECD Principles of 1999 and 2004.

B. Sarbanes Oxley Act - 2002

In spite of these new laws and the lessons of industry, frauds continued. The United States saw the most dramatic frauds on record with the collapse of Enron in 2001 and WorldCom in 2002. These frauds cost investors billions of dollars and shook the world's confidence in the U.S. securities markets. Like the UK before it with the Cadbury Commission, the United States launched a committee to investigate the national policies and practices that could potentially be allowing frauds to occur. Titled after the authors, Senator Paul Sarbanes and Congressman Michael Oxley, the Sarbanes-Oxley Act (referred to affectionately as "SOX") was passed into law in almost record time in the United States in June 2002. The Act tightened up corporate accounting controls and established a new regulatory agency, the Public Company Accounting Oversight Board, to oversee, regulate and inspect accounting firms in their role as auditors of public companies. The Act also established new standards for auditor independence, corporate governance, internal control assessments, and enhanced financial disclosure.

The SOX rules were decidedly unpopular, especially with foreign corporations that were listed on U.S. stock exchanges. It was seen by many detractors as adding unnecessary layers of administration on U.S. firms that made them decidedly uncompetitive in a global world. Proponents of the new Act felt that it helped regain the confidence of global investors.

C. European Reinsurance Regulation – 2003[128]

In 2003 the EU proposed new regulation for the reinsurance industry across member states.56 As a result of the Berkshire/Cologne Re reinsurance fraud in Ireland, the Irish government announced that they would lead the EU by being the first European country to enact these new guidelines into Law. And while Ireland's aggressive position did not carry the same global impact as the Cadbury Report, OECD Principles, or the Sarbanes Oxley Act, they were the first to enact new reinsurance regulations and continued the pattern that "regulation follows fraud". The 2002 Berkshire/Cologne Re (See Section 1.1 – point 11) scandal in Ireland prompted that country (like others before it) to react with new regulation, not only to introduce new controls over the activities of the industry participants but also to regain confidence and demonstrate that the government was taking decisive action.57 Although Ireland's reinsurance industry is relatively small and typically follows the development of new regulations, government, industry, and business leaders felt that Ireland had to take dramatic and swift action in response to the scandal. Some[129] criticized this reaction by saying that Ireland did not have the experience to lead European regulatory change and predicted that they would burden their international reinsurance industry with unnecessary reporting and controls.

In spite of Ireland's proclaimed enchantment with increased regulation in the reinsurance industry, it was ironically its lack of effective regulation in the banking sector that caused the demise of the Celtic Tiger, reversing the good fortunes that Ireland had enjoyed which recorded Ireland as the fastest growing economy in Europe for fifteen consecutive years.

In his book, "Ship of Fools"[130], Fintan O'Toole chronicled the greed and corruption in Ireland's government and banking sector that included allegations of government kickbacks by real estate developers, fraudulent financial activities by bank executives, reduced controls over mortgage valuations and payments, and regulators that turned a blind eye to reported incidences. Banking regulation was so light and ineffective that even problems that had been discovered by bank auditors or regulators were either not reported or not followed up for correction. As O'Toole points out, although new

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[128] Larkin, J. "Developments in European Reinsurance Regulation" - http://www.williamfry.ie/files/indexfile.asp?id=72

[129] Sherin, L. (2004). *'International insurance to go from strength to strength'*, Finance Magazine.com,, See: http://www.finance-magazine.com/display_article.php?i=4328&pi=142

[130] O'Toole, F. "Ship of Fools – How Stupidly and Corruption Killed the Celtic Tiger" - Faber and Faber Ltd, Bloomsbury House, 2009

regulation was being introduced and starting to change corporate governance practices, it was doing very little to actually stop fraud.

The consequences of this situation affected all industry players: even further increased regulation and oversight was implemented across all Irish industries as a result of the inappropriate actions of a few companies within the reinsurance sector.

D. 2008-2010 Global Banking Crisis – Dodd Frank & Basel III

Global Banking Crisis – 2008-2010

Contrary to the immense efforts that have gone into creating better governance and more stable organizations and economies, the greatest crisis of our time was yet to come. In the latter half of the first decade of the 21st century a financial crisis was starting in the United States that would subsequently spread around the world and give rise to what has is regularly referred to in the press as the Global Financial Crisis[131]. In spite of OECD Principles becoming law and controls from the Sarbanes Oxley rules, "the worst Financial Crisis since the 1929 Great Depression"[132] occurred and resulted in the collapse of large, highly leveraged financial institutions. The resultant need was for national governments and banks to bail out private banks and other companies.

What is particularly interesting is that some countries (notably Canada) and some banks (notably the TD Bank in Canada) were less affected by this global meltdown. Was it good governance, good regulation, or good fortune, or all of the above? Before exploring this question further through empirical research, it is necessary to first examine the 2008—2010 crisis in more detail.

The Global Crisis was triggered by a complex set of events. Most economists and central bankers focus on three macroeconomic fundamentals62 when examining the health of an economy: (a) a balanced federal budget (and subsequent levels of debt); (b) trade balances; and (c) current account balances. In the United States, a deficit had been on record for all three categories since the early part of the decade: record historic deficits were first experienced in this period during the Clinton presidency and continued under George W Bush, in part to fund the war effort overseas. While this

[131] Financial Times (2012). *"The Global Financial Crisis"*. August 15, See: http://www.ft.com/intl/indepth/global-financial-crisis
[132] Reuters – "Thee Top Economists Agree 2009 Worst Financial Crisis Since Great Depression" See: http://www.reuters.com/article/2009/02/27/idUS193520+27-Feb-2009+BW20090227

clearly impeded decision-making, the economy kept growing. So what was the magical ingredient that kept the economy afloat? Consumer spending.

During the Clinton regime, the U.S. government decided to repeal the Glass-Steagall Act (sometimes called the Banking Act), which was passed in 1933 and included specific provisions to restrict commercial banks from dealings and affiliations with securities firms. These activities were seen as speculative, outside the scope of traditional banking, and the direct cause of the 1929 Great Depression. However, by the 1960s, US banking regulators had started to ease their interpretation of this Act and allowed these dealings to occur within affiliates of commercial banks. By the late 1990s the restriction was fundamentally gone. It is ironic that as the world was introducing new governance regulations to prevent corporate and economic crises, US banking regulators were reducing barriers to what was once seen as speculative business activity by the same regulatory body.

Another important factor in this crisis was the ever-increasing price of real estate in the US, which peaked in 2006. What is now referred to the US housing bubble allowed consumers to see real growth in their net wealth through home ownership. There are several key features about the US housing market that fueled the impending global collapse:

- A U.S. tax provision allows taxpayers to deduct loan interest paid on their income tax returns, including mortgage interest. This provides consumers an incentive to always hold debt.
- There are no minimum down payments for home ownership and, in some cases, mortgages could be issued at values over 100% of the house prices
- Consumer liability for mortgage holders is limited to the property itself. If the value of the property were ever to fall below the current outstanding mortgage, the borrower could walk away from the house and the mortgage without any further consequences to their other personal assets
- The tax rules encouraged homeowners to remortgage their existing property to obtain cash on unrealized gains. That fuels additional consumer spending, all with tax deductibility
- Banks feel that the capital they are required to hold on their books to support the mortgages they sell is costly. In the United States, it has become common practice for banks to reduce these capital requirements by securitizing and selling off their mortgages to third parties who are interested in stable, above-prime rates of return.

By selling the mortgages, the banks no longer owned the risk of creditor defaults and also freed up the banks' capital to make new mortgage sales.

This is the making of a perfect storm – consumers are incented to buy houses with little money down and little downside risk; consumers are then encouraged through tax deductibility on their mortgages to use their houses like cash machines by refinancing mortgages to gain access to unrealized gain in their homes which fuels consumer spending; an economy (and therefore a government) that was solely buoyed by consumer spending therefore encouraged consumers to spend; and a commercial banking system that encouraged banks to sell their mortgage debt in order to make more mortgage sales and therefore more profits. These risk factors increased when investment bankers and speculators[133] continued to evolve these practices toward the "subprime debt" market – consumers who did not have the normal credentials for borrowing, but as long as housing prices went up, they could buy a house with no down payment (based on the above rules) live there for some period of time, sell it off at a profit and then pay off the mortgage, having lived rent free for some period of time. Mortgage agents who were not part of the commercial banking institution could sell mortgages to consumers that would normally not have qualified for them. It appeared win-win: more people were able to receive a mortgage and own a house and mortgage agents received their fees for selling mortgages to more people.

Commercial banks were comforted by the knowledge that they could package up mortgages through securitization and offload these low grade investments to third party investors removing any risk from their own financial statements. Rating agencies were less than diligent and provided favorable investment ratings to these investments. Both domestic and international investors and banks unwittingly bought these highly rated but highly risky investments.

For a humorous but reasonably accurate portrayal of the dynamics that came into play in this financial tragedy, I direct readers to a web-based presentation entitled "The Subprime Primer"[134].

These practices could have worked as long as housing prices continued to escalate. But in 2006 the US housing bubble collapsed and prices fell and continued to fall for

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[133] Globe and Mail, "How Speculators fed U.S. housing bubble, fueled bust", M. Babad, Dec 16, 2011
[134] For "The Subprime Primer" please see:
https://docs.google.com/present/view?skipauth=true&pli=1&id=ddp4zq7n_0cdjsr4fn

the next three years. When the housing bubble burst, consumers who owned homes that were now materially below their actual mortgage values simply walked away from their houses, rather than pay back inflated loans. As houses emptied, the negative spiral continued. Consumer spending, the one ingredient that was bullying the U.S. economy, was harshly reduced and consumers were advised to save rather than to borrow or spend. The reduction in consumer spending caused the already weakened U.S. economy to decline further. Unemployment grew and other sectors of the economy—such as the critically important auto industry—were also affected, and forced the need for government bailouts to the auto industry.

This plummet severely damaged financial institutions in the United States that owned the securitized mortgages and many banks, particularly investment banks, were severely affected by the crisis. Lehman Brothers, for example, which was the fourth largest investment bank declared bankruptcy, having posted 2006 revenues of $46.7 billion[135]. It is the largest bankruptcy in American history. Goldman Sachs, Morgan Stanley, and Merrill Lynch were also severely damaged. If all four banks happened to collapse during that crisis, it was said that there would be a general implosion of the entire U.S. banking system, the effects of which would cause a world-wide collapse through contagion. The U.S. Treasury was given authority to issue $700 billion as a bailout package for affected national and foreign banks.

These dramatic events damaged investor confidence and impacted the U.S. stock and bond markets. A subsequent effect was the decline of other stock markets around the world. The term *contagion* was introduced as foreign markets that saw the United States as either a financial partner or as a market for their consumer goods were negatively affected. Banks and other countries that owned these securities or had direct or indirect exposure to the U.S. market saw the value of their securities decline. The U.S. banking crisis was now a global phenomenon and it threatened to trigger our world-wide recession. The U.S. Senate called for a review. The Levin-Coburn Report[136] was published in 2009 and it found that "the crisis was not a natural disaster but the result of high risk, complex financial products; undisclosed conflicts of interest; and the failure of regulators, the credit agencies, and the market itself to rein in the excesses on Wall Street".

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[135] Fortune 500, Annual rankings, 2007
[136] US Senate Financial Crisis Report - "Wall Street and the Financial Crisis: Anatomy of a Financial Collapse" pp 1-11

As with each new crisis, new regulations followed. At the time of this writing both U.S. and global regulators are examining what new sets of rules should be put into effect to prevent a crisis of this nature from ever happening again. Examples include:

Dodd-Frank Act

In the US, much anger was targeted against Wall Street and the investment banks that were generally blamed for causing the crisis. By early January, in the final weeks of George W. Bush's administration, CNN estimated that $7.2 trillion[137] had been pledged in loans or investments to bail out various sector of the U.S. economy. By June of that year the Obama Administration had proposed a new law to reform Wall Street and to increase consumer protection. In July 2010, after various iterations and amendments, the Dodd-Frank Wall Street Reform and Consumer Protections Act (Dodd-Frank) was signed into law. This was the most significant financial reform in the United States since the Glass-Steagall (Bank Act) that followed the stock market crash and depression in the 1930s.

Dodd-Frank[138] included the following key recommendations for financial reform:

- **Consumer Protection with Authority and Independence:**
  The creation of a new independent watchdog, housed at the Federal Reserve, with the authority to ensure American consumers get the clear and accurate information they need to shop for mortgages, credit cards, and other financial products, and protect them from hidden fees, abusive terms, and deceptive practices.

- **The end of Too Big to Fail Bailouts:**
  A provision to end the possibility that taxpayers would be asked to bail out financial firms that threaten the economy by creating a safe way to liquidate failed financial firms. This required tough new capital and leverage requirements be imposed on banks. The Federal Reserve's authority was updated to support – but no longer prop up – individual firms by establishing rigorous standards of supervision.

- **New Advance Warning System:**
  A new council would be created to identify and address systemic risks posed by large, complex companies, products, and activities before they threatened the stability of the economy.

[137] CNNMoney, January 6, 2009 – See: http://money.cnn.com/2009/01/06/news/economy/where_stimulus_fits_in/
[138] Dodd-Frank Act - http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf

- **Transparency & Accountability for Exotic Instruments:**
  Existing loopholes that allowed risky and abusive practices would be eliminated. This measure affected derivatives, asset-backed securities, hedge funds and mortgage brokers.

- **Executive Compensation and Corporate Governance:**
  Shareholders would be given non-binding votes on executive compensation and severance (golden parachutes).

- **Investor Protection:**
  Tough new rules for transparency and accountability in rating agencies would be introduced to protect investors and businesses. One example of these rules was the introduction of liability against the rating agencies themselves.

- **The Enforcement of Regulations:**
  Additional new responsibilities and powers of oversight would be developed to allow regulators to aggressively pursue financial fraud, conflicts of interest and manipulation of the system that benefits special interests.

The sheer volume of changes and new regulations was controversial. Bank leaders felt their businesses would be competitively hindered by new limits to proprietary trading of derivative products and the $19 billion tax created to pay for the Dodd-Frank bill. The new powers of the Federal Reserve (including the new Consumer Protection Agency) increased concern that new bureaucracy would raise costs for consumers. There was also serious concern about the introduction of new "whistleblower rules" (Section 922) that would pay financial awards to people who provided the SEC with original information on securities violations. Due to the vast number of changes, the Act was designed to be implemented in phases and responsibility was delegated to various US agencies to implement changes on a prescribed timetable.

According to the US based international legal firm of Davis Polk LLP,[139] the Act required regulatory agencies to create 243 new rules, conduct 67 studies and issue 22 periodic reports (See Table 3 – "Estimates of Rulemaking by Agency"). The sheer enormity of the follow-up made it controversial because the changes prescribed would

[139] Ibid, p ii

affect every financial institution in the United States as well as foreign financial institutions and companies that did business with these firms.

While the notion of new and more effective reforms was always the aim of Dodd-Frank, the banking industry and other affected stakeholders were dismayed by the scope and range of the proposed changes. It was seen as "anti-business" because it increased bureaucratic and consumer costs for financial services, so many groups of political insiders and lobbyists were opposed to the bill's full implementation.

Table 3: Dodd-Frank – Estimates of Rulemaking by Agency[140]

Agency	All Rulemaking*	One-Time Reports / Studies	New Periodic Reports
Bureau	24	4	5
CFTC	61	6	2
Council	56	8	4
FDIC	31	3	1
Federal Reserve	54	3	3
FTC	2	0	0
GAO	0	23	2
OCC	17	2	2
OFR	4	1	2
SEC	95	17	5
Treasury	9	1	1
Total**	243	67	22

(Source: Davis Polk LLP)

Dodd-Frank became a political football for the Democratic-based Obama Administration, who faced a Republican-led House Appropriations Committee that was responsible for approving government expenditures. Philosophically and economically conservative and with a political agenda against "big government", the Republicans stalled the implementation of Dodd-Frank by cutting back on the financial requests from the Securities and Exchange Commission (SEC) to release the approved $1.5 billion funding needed to implement it. And since the Act was already seen as controversial because of its complexity and scope, many influential participants were wary of these new rules and favorable of the delays (and possibly even the demise of Dodd-Frank). Opponents of Dodd-Frank, including the outgoing

[140] Davis Polk, LLP – "Summary of Dodd-Frank Wall Street Reform" July 21, 2010 - See: http://www.davispolk.com/files/Publication/7084f9fe-6580-413b-b870-b7c025ed2ecf/Presentation/PublicationAttachment/1d4495c7-0be0-4e9a-ba77-f786fb90464a/070910_Financial_Reform_Summary.pdf

Chairman of the American Bankers Association, Stephen Wilson,[141] made headlines by saying Dodd-Frank was “Job-killing bank regulations (that) threaten to wipe out all the gains in private-sector employment logged since the recovery began” at a time when unemployment was near record highs in the United States.

By the end of December 2011, Davis Polk[142] reported that “200 Dodd-Frank rulemaking required deadlines had passed” (i.e. deadlines had been missed) and “70% of the 286 rulemaking requirements with specified deadlines” had also been missed. Of the 400 total rulemaking requirements “21.5% have been finalized, …, 38.8% have been proposed, ... and 39.7% have not yet been finalized”. Speculation currently ensues whether the Dodd-Frank is in trouble of making further progress.

This is an important observation. Over-regulation or over-zealous regulators can be as much of a deterrent to “good corporate governance” as poor regulation can be.

Basel III

The Basel Committee on Banking Supervision was formed in 1974 by the G-10 (actually 13 countries at the time). The purpose of the new committee was to increase consensus and cooperation by allowing central bank governors an opportunity to meet with their international peers to discuss global financial matters. The ultimate goal of the Basel Committee was to improve banking supervision locally in each country and around the globe. The Committee first came together as a reaction to a serious disturbance in international currency and banking markets. The issue at the time was the gap in time zone differences between Europe and North America, which negatively affected correspondent banks in the US when currency settlements of Herstatt Bank[143] in the United States to fail due to the failure of this bank earlier in the day in Germany. Canada was a founding member. Since the group met at the Bank for International Settlement in Basel, Switzerland, it soon came to be known as the Basel Committee. It now has twenty-seven members.

Although the Committee does not have any formal powers of legislation, it has published dozens of broad supervisory guidelines for consideration by member countries, including the following:

[141] Investor ‘s Business Daily – “Dodd-Frank Rules Will Crush Employment – Banks Warn” Dec 12 2011
[142] Davis Polk, LLP – “Dodd-Frank Progress Report, January 2012”, p 2
[143] Bank for International Settlements – “History of the Basel Committee” – See: http://www.bis.org/bcbs/history.pdf

- 1975 – Concordat (Adopted in 1978 and revised in 1983 and 1990)
- 1983 – Principles for the Supervision of Banks' Foreign Establishments
- 1988 – "Basel I": Basel Capital Accord (amended in 1991 and 1996)
- 1992 – Minimum Standards of Concordat
- 1996 – Proposals for Cross-Border Supervision of International Banks
- 2004 – "Basel II": New Capital Adequacy Framework (amended in 2006, 2007, and 2008 and completely in 2009)
- 2010/2011 – "Basel III": Capital Adequacy, Stress Testing & Market Liquidity

Basel III proposed changes specifically to address the global banking issues that emanated from the 2008–2010 global financial crisis. Proposals included increased capital requirements for banks and the introduction of new requirements for bank leverage and bank liquidity. These new rules have explicit impacts on the capital requirements that international banks were required to hold on behalf of their international subsidiaries.

Similar to Dodd-Frank, Basel III has a proposed implementation timeframe that commenced in January 2013 and extends out to 2019. By 2013 banks will be required to meet minimum risk-weighted capital requirements of 3.5% share capital, 4.5% Tier-1 capital, and 8% total capital. These amounts increase to 4.5% share capital, 6% Tier-1 capital and 8% total capital in 2019. Although the G20 in Seoul endorsed the Basel III framework in its entirety, there was divergence in the implementation of Basel II. The same looks inevitable for Basel III. This framework has serious consequences for our research. Embedded in Basel III is a regulation to harmonize capital requirements across international lines and increase capital requirements on noncore banking businesses like insurance.

This implies two key issues to our body of research on international banking subsidiaries. First, individual sovereign countries and their local bank regulators are currently able to determine the capital requirement needs for their own home markets. Often there exists an arbitrage opportunity for banks to open operations in international locations due to the benefits of lower capital requirements. They are thus able to realize different returns of capital than they could normally generate in their home markets. As the risk profiles of the international business will also differ from the home market, we can presume that each bank finds itself with capital regulations that depend on specific countries, either adjusting their pricing to balance capital with risk-weighted assets in an international market or enjoying a premium return by offsetting perceived increases in their operating risk profile. In either event, the Basel III regulations are attempting to change this dynamic and affect the capital requirements that international banks will have to allocate to the foreign subsidiaries where these difference occur. This will result in increased operating costs and reduced risk-weighted returns on capital. Since the Canadian banks, for example, tend to follow the highest standard of OECD and Basel principles while other countries do not, competitive advantage would thus lay with those who are more relaxed with their level of adoption. This is clearly an acute concern for bankers worldwide.

Secondly, while opportunities for international companies to enter a business might make sense on their own merits, there may be difficulty in demonstrating how the international business is core to the main strategy of the corporation. In these cases, additional capital will once again be required to shore up international subsidiaries that banks cannot demonstrate as being aligned to their “core” strategy. In the context of Basel III we may thus see banks needing to divest or diversify away from their international strategies or subsidiaries. This would effectively be caused by the increased capital requirements imposed by home regulators as a result of the situations listed above and ultimately reduce international subsidiary networks and business profiles.

Future Developments

Looking ahead to the future of multinational and transnational corporations it is clear that international entities represent economic opportunities to both home and host countries. From the examples recently provided it is also apparent that regulation alone does not lead to good governance. Corporate governance and the development of a new financial architecture are only now beginning to receive the attention they deserve.

The history[144] of corporate governance demonstrates the weaknesses present in our current use of regulatory efforts as a panacea for governance concerns. To this end, many academics are exploring new and more modern forms of enterprise structures like “democratic capitalism”. Democratic capitalism[145] is defined by Webster’s as “an economic ideology based on a tripartite arrangement of a market-based economy

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[144] Bond Law Review 259 [1999] – “A Brief Thematic History of Corporate Governance” - John H Farrar

[145] Webster’s Online Dictionary – See: www.websters-online-dictionary.org/definition/**Democratic**+capitalism

based predominantly on economic incentives through free markets, a democratic polity and a liberal moral-cultural system which encourages pluralism".

Similarly, Van den Berghe and de Ridder (1999)[146] focus on international standards for corporate governance and argue for the evolution of a more democratic model of corporate governance. Their proposition suggests a new form of governance that is be characterized by:

(a) Knowledge workers empowered as a result of the communications revolution
(b) A power shift from shareholders towards the knowledge worker
(c) A sense of shared values

Like Van den Berghe and de Ridder's research, I too seek mechanisms to extend the responsibility and control for corporate governance from the main board of directors to every employee. These characteristics they list could play an increasingly important role in the field of corporate governance especially as we examine the softer side of governance in international subsidiaries.

2.1.5 Industry Guidelines:

As countries adopted the OECD Principles in 1999 and enacted new laws into their own companies' acts, individual corporations had little choice but to embrace these new laws. In Canada, for example, Bill S-11 was passed in May 2001 and imposed new regulations on companies and boards. Bill S-11 outlined a number of new requirements that affected corporate interrelationships, specifically relative to shareholders dealings, director independence, insider trading and the responsibility of the board. These wide-reaching laws defined the way boards and subcommittees were to be constructed and detailed how the board should conduct its affairs. It also underscored the responsibility that each board member had to understanding the business decisions being made, as well as the personal liability each director carried as a result of their involvement on the board. Though national laws are unique to each country, they were adjusted to be aligned with the spirit and goals of the OECD's Principles for Corporate Governance. As time unfolded, the OECD Principles effectively became the corporate law of the land in most countries.

[146] Van den Berghe, L & De Ridder, L (1999), International Standardization of Good Corporate Governance., Boston/Dordrecht: Kluwer Publishers.

As the Principles became law, boards of directors unilaterally embraced the new regulations and changed the way they structured and managed their affairs. For example, when I conducted a telephone interview with the Chairman of the Board at Canada's largest financial institution, the Royal Bank of Canada (RBC), David O'Brien[147] noted that other financial institutions were on relative par with their governance standards:

> **"RBC has an excellent Board carefully crafted for its skills and diversity. I would say that most Boards have generally taken the issue of corporate governance very seriously especially over the ten years and RBC is not too different from other firms in the area of governance processes or practices."**

So while RBC regularly wins accolades for its corporate governance processes from industry agencies and various surveys, O'Brien felt that RBC' was no further ahead than most other Canadian banks. His belief that most companies in Canada have implemented similar changes "over the last 10 years" also points to the effect that the OECD Principles in particular have had on the landscape of corporate governance. Chairman O'Brien's comments further underscore the effectiveness of a "regulatory-led" approach to affecting corporate behaviors if the goal is compliance on a rules-based formula.

In addition to various national laws being passed to address the OECD Principles, numerous agencies and industry associations sprang forward to monitor company compliance in their nations with these new rules and regulations, including the following:

Accounting Standards Board - UK
Accounting Standards Board of Japan - Japan
American Institute of Certified Public Accountants - USA
Association of Chartered Certified Accountants - Global
Australian Accounting Standards Board - Australia
British Accounting Assoc. Corporate Governance Special Interest Group - UK
Certified General Accountants Ontario - Canada
Clarkson Centre for Business Ethics and Board Effectiveness - Canada
Deloitte Audit Committee Online - Global
Financial Accounting Standards Board - Global

[147] Interview with David O'Brien, Chairman of RBC – Nov, 24, 2007 (by telephone)

Internal Controls - A Review of Current Developments - UK
International Accounting Standards Board - Global
International Federation of Accountants - Global
International Forum on Accountancy Development - Global
Institute of Chartered Accountants of India - India
Malaysian Accounting Standards Board - Malaysia

Monitoring Industry Changes:

Not only have industry associations formed to monitor company compliance to these new rules but the media have also elected to play a monitoring role. As discussed in Section 2.1.3 (Canadian Contribution), Canada's national daily newspaper the Globe and Mail conducts an annual ranking of companies according to their adherence to practices of corporate governance. The *Globe and Mail's* Board Games[148] has become an annual watchdog for company compliance through published "report cards". As a result of this public reporting, Canadian companies actively engage their public relations departments to review their rankings and improve their performances each year.

Also mentioned in Section 2.1.3 is the Clarkson Centre for Business Ethics and Board Effectiveness (CCBE)[149] which is another leading monitoring agency in Canada. Like the Globe and Mail, the CCBE has also researched and ranked Canadian companies on their "boards of directors, social networks and corporate performance"[150] for the past ten years. The CCBE maintains a comprehensive database[151] of board-related information for all companies listed in the Toronto Stock Exchange-Standard and Poor 300 Composite Index (S&P TSX 300). The CCBE believes that independent and effective boards drive good corporate governance. Their annual review focuses on 14 key indicators of the Board. The CCBE obtains their data from publically available corporate information circulars and annual reports from these top 300 companies (less trusts) and has published their findings since 2002.

[148] Globe and Mail Board Rankings - http://business.theglobeandmail.com/v5/content/boardgames/index.php?year=2008
[149] CCBE – for more information see: http://www.rotman.utoronto.ca/ccbe/
[150] Clarkson Centre for Business Ethics & Board Effectiveness – Board Shareholder Confidence Index, December 2007
[151] Mr. Matt Fallbrook, Manager of the CCBE is a member of my Canadian-based Advisory Committee for my thesis.

These 14 attributes focus on the structure and evaluation process of the board, examine the independence of board directors and review the board compensation mechanisms in place to ensure they align with shareholder interests, and in turn generate good corporate governance. The CCBE assigns numerical values to each variable (see below) which allow for quantitative grading and comparison of these companies. Variables are reviewed annually and added periodically (2007) added to the review to evolve the process and ensure it remains relevant over the years.

The 14 key attributes are:

- Director Independence
- Interlocking Directorships
- Excessive Board Memberships
- Stock Ownership of Board Directors
- CEO/Chairman Split (Board structure)
- Committee Independence
- Share (Voting) Structure of various company shares
- Board Evaluation processes and Director Evaluation processes
- Board & Executive Options (Dilution Effects)
- Options Re-pricing
- CEO Pay (related to performance)
- Evergreen Options Plans (Maximums on Executive and Director Options)
- Loans to Directors and Executives
- Director Pensions

The monitoring work performed by the CBBE and others is particularly relevant to my book research because the tracking and results they provide allows connections between regulation and implementation to be traced. We can thus trace the effect of regulations like the OECD's Principles and see firsthand the effects they have on the behaviours and actions of companies. By further examining the CCBE methodology to ensure consistency from year to year, one can also empirically measure how companies follow these rules, which provides additional insight into the question of whether regulation generates good governance principles. In other words, efforts like the CBBE allow the effect of regulation on companies to be traced.

Two additional questions relative to corporate monitoring require examination: How have individual industries reacted to the OECD Principles? And how have companies and industries changed over time: are companies getting better at complying with the OECD Principles and are industries and countries changing as a result of regulation? These questions are important for understanding the effects of regulation on company behaviour. A review of the CCBE's methodology and findings will provide insight into these questions.

CCBE's Methodology for Grading "Good Corporate Governance":

Companies analyzed by the CBBE are graded on the 14 attributes listed above. See the "CCBE Board Shareholder Confidence Index"[152] for the scores by Company from 2003 to date. The CBBE collects data from each company's annual report and information circulars. Each company starts with a perfect score of 100 and any identified deviation creates a deduction from this score. Deductions are made against each attribute using the following methodology:

1. **Board Independence:**

   Directors are considered "related" and *not* independent if they are:

   a. an employee of the company or a related company (within three years)
   b. an executive of any affiliated company
   c. providing the firm with legal, auditing, or consulting services (last 3 years)
   d. related (i.e. kinship) to the CEO
   e. related, as deemed material by CCBE (not in any above categories)

   No deductions are made against the company if more than 2/3 of the directors are considered "independent". The 2/3 mark is deemed reasonable because it allows closely related family companies to be included in the rating system. It also recognizes the need for some board members to be from management or otherwise related. If the board remains below the 2/3 level of independence, deductions are made against the company score in the following manner:

   - 66.7% or more - no deduction
   - 60% - 66.7% - Deduct 3 points
   - 50% - 60% - Deduct 5 points
   - 30% - 50% - Deduct 10 points
   - Less than 30% - Deduct 15 points

[152] Clarkson Centre for Business Ethics and Board Effectiveness, "CCBE Board Shareholder Confidence Index", See: http://www.rotman.utoronto.ca/ccbe/details.aspx?ContentID=211

2. Interlocking Directorships:

5 points are deducted if more than two directors sit on more than one board together.

3. Excessive Board memberships:

Any director that is a member of more than five boards creates a deduction of 5 points per director.

4. Stock Ownership:

To ensure affiliation with shareholders, directors are expected to own company stock. The rule of thumb in the industry in Canada is that directors with over three years on the board should own a multiple of four times their annual retainer. Companies are scored based on the average holdings of the third of directors with the fewest holdings. Average results that are below the benchmark retainer generate a sliding scale of deductions at 3, 5, 10 and 15 points against the company's overall score.

5. CEO/Chairman split:

The CCBE sees the split and independence of the CEO and chair as critical for good governance, so deductions are substantial if this is not the case. For example, 10 points are deducted if the CEO and the chair is the same person. Only 7 points are deducted if these roles are split but the individuals are not independent. 5 points are deducted if either there is no split but for good practice another independent director serves a Lead Director in chairing Board meetings or if a Lead director is used when the roles are split but the individuals are not considered to be independent. Otherwise, no points are deducted.

6. Committee Independence:

Despite the fact that many board directors (especially in smaller firms) may fail the independence test listed above, the CCBE and the Canada Business Corporations Act advocate for the independence of directors on audit, compensation and nominations committees. As a result, 10 points are deducted if a single related director sits on the audit or compensation committees or if two related directors sit on the Nominating Committee.

7. Share Structure:

Voting structure of shares needs to reflect the rights of all shareholders. Companies often have several distinctions of shares and debt. In the past some companies have created "super shares" which carry large multiples of voting rights and puts extraordinary voting power into the hand of a minority of shareholders. Punitive deductions are scored against a company if the voting rights of minority shareholders are diluted to any great extent. The scale is as follows: 30 points are deducted if less than 20% of equity value controls more than 80% of voters' rights; 20 points are deducted in 40% or less of equity value controls more than 60% of voters' rights; and 15 points are deducted if less than 50% of equity value controls more than 50% of voters' rights. No points are deducted if there are no dual classes of equity or no subordinated shares or if > 50% of equity controls > 50% of voters' rights.

8. Board and Director Performance Evaluations:

Consistent with Hilb's Reversed KISS Principle for effective board performance,[153] part of good governance includes ongoing methods of evaluation. Having the board evaluated by a number of key stakeholders or ensuring that the performance of individual directors are reviewed by their Chair and other peers are common examples of this practice. For the purposes of the CCBE's scoring, 5 points are deducted if individual directors are not evaluated in a formal process. A further 10 points are deducted if there is no system for evaluating the performance of the full board.

9. Share Dilution:

Consistent with the standards set by the Toronto Stock Exchange on the issuance of stock options, 5 points are deducted if stock options granted to the CEO exceeds 5% of a company's outstanding shares and 10 points are deducted if total options granted by the company exceeds 10% of company shares.

10. Option Re-pricing:

When a company's share price has suffered due to poor market conditions or poor company performance, the strike price of a stock option can actually be higher than the market price of the shares it is associated with. Since re-pricing options can be viewed as mitigating the responsibility of directors for the

[153] Hilb, "New Corporate Governance" 2006, pp 116-128

company's performance, 20 points are deducted if a company has re-priced their options within 3 years of issuance.

11. **CEO Pay Related to Performance:**
Due to the significant role that the CEO plays in directing a company's financial performance through the actions of its executives and employees, 15 points are deducted if the CEO's bonus is not directly tied to company performance.

12. **Evergreen Option Plan:**
"Evergreen Option Plans" are usually pre-approved stock option arrangements based on a specific percentage of outstanding shares. These plans by-pass shareholder approval and allow management to issue options without specific agreement of the shareholder base. Because direct shareholder approval is by-passed in compensating executives with these plans, 5 points are deducted against companies with Evergreen Option Plans.

13. **Outstanding Loans to Directors or Executives:**
In the past it was common to offer executives, directors and other key employees interest-free or other loans as a component of their overall compensation package. Since these benefits are not linked to company performance and can be distracting to executive performance, 15 points are deducted if the company has outstanding interest-free loans, 10 points are deducted if the company has outstanding interest-bearing loans and 5 points are deducted if the company has outstanding loans but has discontinued granting loans.

14. **Director Pensions:**
Director independence precludes the notion that companies should be tying their directors to the company with pension arrangements. As a result, 10 points are deducted against a company that offers their directors a pension plan.

Total Scoring and Grading:

Following the above formula, points are deducted from a base score of 100 to produce a company score. While it is possible to generate an overall negative total, it is very rare that this actually happens in practice. In the 198 companies measured in 2008, for example, the mean score received by companies was 67.8 and only 2 were given negative ratings. The scoring process is reasonable, logical and equitable and the results meaningful to companies as a methodology for comparative purposes. When all 14 measures are accounted for, company scores are then translated into a "Report Card" grade following the methodology provided in Table 4 above:

Table 4: CCBE Grading system

Overall Score	Grade
100	AAA+
95 – 99	AAA
90 – 94	AA
75 – 89	A
50 - 74	B
<50	C

(Source: CCBE 2007[154])

This scoring formula is an effective methodology for monitoring, comparing and ranking the relative strength of governance measures within companies. As we will see momentarily, the companies that are rated take these ratings very seriously and seek advice from the CCBE on where they were deducted and what they need to do to improve their scores for future years. The rates of industry acceptance and feedback underscore the validity of this process.

The CBBE scoring system was developed in 2002 and remained consistent until the methodology for calculating shareholder confidence was materially changed in 2008. This makes it relatively easy to evaluate companies and industries within a given year but notably more difficult to compare results across a given period of time. That said, these methodological issues do allow a five-year trending analysis to be performed between the years 2002 and 2007. This makes the CBBE scoring system particularly useful for research examining Canadian banks.

Evaluating Industry Improvements – 5 years of CCBE Monitoring:[155]

It is interesting to note that the CCBE focuses on individual companies and performs no specific analysis at the industry level. 84 However they do allocate each company to one of eleven industries. The information collected by the CCBE is contained in an

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[154] Clarkson Centre for Business Ethics and Board Effectiveness – 2007 Score Sheet: http://www.rotman.utoronto.ca/ccbe/compositeindexscores2007.pdf
[155] ibid

Access database and is available for public research. For comparative purposes I sorted the 2007 results into industry groups and extracted "Banks" from the broader "Financial Institutions" category to give this sector specific attention. I was then able to total and examine these industry groups in Table 5 on the prior page. Again, due to material changes to the methodology performed in 2008 I provide the 2007 "Industry Results" for comparative review to the earlier data provided.

Table 5: CCBE 2007 Industry Results

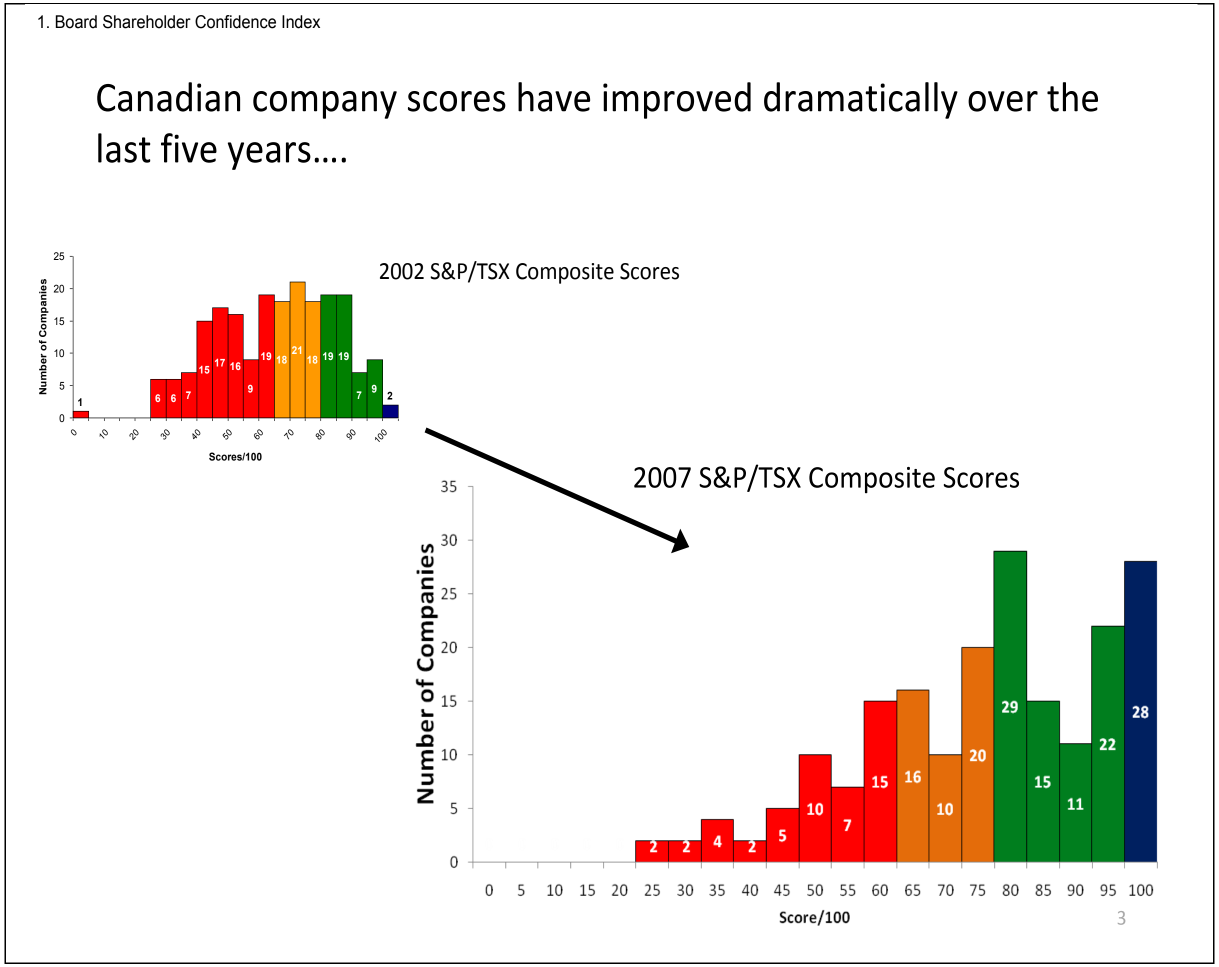
Industry	**Number**	**Total**	**Mean**	**Grade:**
Mining:	2	155	77.5	A
Consumer Discretionary:	21	1258	59.9	B
Consumer Staples:	12	837	69.8	B
Energy:	38	2471	65.0	B
Financials (Excl. Banks):	18	1145	63.6	B
Health Care:	6	413	68.8	B
Industrials:	19	1496	78.7	A
Information Technology:	9	650	72.2	B
Materials:	55	3535	64.3	B
Telecommunications Services:	3	295	98.3	AAA
Utilities:	7	459	65.6	B
Totals (Excl. Banks)	**190**	**12714**	**66.9**	**B**
CANADIAN BANKS *	8	707	88.4	A
Totals (Including Banks)	**198**	**13421**	**67.8**	**B**

(Source: CCBE 2007 Shareholder Confidence Index)

As presented in Table 6 on the following page, in 2007, the mean score in 2007 for the 198 companies surveyed was 67.8. This resulted in an overall B Grade according to the CCBE's grading system. Across the twelve sectors represented by my analysis, the lowest average group score was 59.9. This was for the Consumer Discretionary group, which accounts for companies that include retail outlets, tobacco companies, and cable TV companies. The highest average score was 98.3, for Telecommunications Services. It should be noted that there were only three companies in this category, however, so the question of validity is obviously raised. The variance in this industry group is very narrow, so that implies that other companies within this industry would have received similar scores.

Table 6: CCBE's Canadian Scores over Time

Score Range	2002 #	2002 %	2007 #	2007 %
96% - 100%	2	1.0%	28	14.1%
91% - 95%	8	3.8%	22	11.1%
86% - 90%	7	3.3%	11	5.6%
81% - 85%	19	9.0%	15	7.6%
76% - 80%	19	9.0%	29	14.6%
71% - 75%	18	8.6%	20	10.1%
66% - 70%	21	10.0%	10	5.1%
61% - 65%	18	8.6%	16	8.1%
56% - 60%	19	9.0%	15	7.6%
51% - 55%	8	3.8%	7	3.5%
46% - 50%	18	8.6%	10	5.1%
41% - 45%	17	8.1%	5	2.5%
36% - 40%	16	7.6%	2	1.0%
31% - 35%	7	3.3%	4	2.0%
25% - 30%	6	2.9%	2	1.0%
21% - 25%	6	2.9%	2	1.0%
16% - 20%				
11% - 15%				
5% - 10%				
1% - 5 %	1	0.5%		0.0%



(Source: CCBE 2008)

It is extremely interesting to note that banks, when isolated as a distinct group, obtained the second highest average (88.4). Eight companies were represented by this sector according to the TSX S&P 300, again underscoring the leadership role that banks in Canada have played for over a decade in having practices, processes and structures intended to achieve good governance.

How have scores changed over time? By examining these same industry sectors between 2002 and 2007 (see table 6 and figure 3), a pronounced shift can be identified: companies have without exception progressed toward stronger scores. Two key indicators to note are the following: first, by 2007, 63% of all companies scored 70% or higher compared to only 34.7% of companies in 2002; second, in 2002, 40% of companies scored below 50% but that number dropped to 12.6% by 2007.

With more companies scoring higher and fewer companies scoring lower, the twofold trend indicated by the CBBE scores reveals that "companies actively engaged CCBE to understand how their scores were created and what they needed to do to improve their rankings".[156] Companies have clearly taken the CCBE "Board Shareholder Confidence Index" seriously and worked in an almost competitive fashion to improve their rankings. This further demonstrates that regulation combined with monitoring, ranking and reporting does drive significant corporate change—companies changed their boards of directors, structures, and behaviours. And while monitoring of this kind subsequently supports the mantras "regulation drives change" and "what gets measured, gets done," the question remains whether better board structure and behaviour actually generates good governance.

2.1.6 Limits of Regulation:

At this point it should be clear that breaches and failures of corporate governance are serious problems for business leaders, regulators, employees, governments other stakeholders and society in general. As a result, regulators were required to introduce new regulations, in part to prevent the reoccurrence of similar breaches but also to demonstrate to their constituents that they have taken the consequences of these breaches seriously. These rules and monitoring practices

[156] ibid, Matt Fullbrook, Manager CCBE, University of Toronto

have in turn forced companies to change their board membership and organizational structures, their behaviour, and their policies. It is safe to say that corporations generally comply with these new regulations. Industry change occurs as a result and the competitive climate for companies and industries evolve along with it.

In Canada the OECD’s Principles of Corporate Governance were turned into law through Bill S-11. The components of Bill S-11 were taken by the Clarkson Centre for their monitoring review. As I demonstrate above through the CCBE, companies changed their behaviours and structures. In Canada we can see that regulation does drive change. It is unquestionable that the speed with which these changes were implemented was directly affected by monitoring and reporting agencies like the Clarkson Institute, whose ratings and report cards motivated companies to adopt industry regulations.

But are the efforts at regulation alone enough to ensure good governance? The answer must unfortunately be negative. I have demonstrated that regulation, while effective in drawing attention to the issue of governance and creating laws that support it, is still not eliminating fraud or other governance breaches. A review of the corporate scandals found in How a Problem Became a Crisis, in comparison with the dates that regulation has been passed around the world (see appendix A), will illustrate that breaches of corporate governance have continued to occur in spite of new laws and regulations. Take for instance the series of laws passed in the United States after the OECD Principles of Corporate Governance were instituted in 1999; just three years later both Enron and WorldCom failed. And while these failures led to Michael Sarbanes and Paul Oxley introducing comprehensive new regulations for all U.S.-listed companies, the financial world was devastated again by the U.S.-led subprime crisis of 2008. The fact that this same year also marked the closure of the largest single fraud in U.S. history[157] showcases the clear limits of regulation.

In spite of these limitations, regulators worldwide continue to develop regulations and laws for companies and organizations. For example, on March 26, 2009, the U.S. Department of the Treasury announced its intention to launch

[157] Forbes Magazine - http://www.forbes.com/2008/12/12/madoff-ponzi-hedge-pf-ii-in_rl_1212croesus_inl.html

yet another round of regulations.[158] This announcement came as the world was struggling in the depths of the global financial crisis that ultimately led to the passage of the Dodd-Frank Act in the United States. With similar reaction, the G30 endorsed Basel III globally. And yet in spite of these quick and comprehensive reactions, there are signs that countries will be able to individually decide the extent to which they will adopt the Basel III regulations. Lessons from recent history may lead us to conclude that these new rules will become law in the United States and other countries, of course, but the same historical lessons would force us to question whether that will be enough to prevent the next series of corporate frauds.

A question that can and should be asked is if something is fundamentally wrong in the pursuit of good corporate governance by regulatory recommendations alone. Current debates around this question center on the difference between rules-based and principles-based approaches to governance, so an investigation into the arguments for both side will shed light on the limits of regulation.

Rules-based versus Principles-based

The debate between rules-based versus principles-based approaches has been active for decades in the accounting profession, in which the United States subscribes to rules-based approaches and Canada and the United Kingdom both favor principle-based approaches. This debate is also active in the world of corporate governance. In their original 1999 directive, for instance, the OECD chose to introduce their recommendations for corporate governance under the moniker principles. Canada, the United Kingdom, Hong Kong, and Germany followed this lead and each generally advocate for principles-based strategies.[159] The US, in contrast, most often opts for a rules-based approach.

There are advantages to each position. In this debate, the proponents of rules-based approaches argue that rules provides a common playing field for all participants and are specific enough to leave little room for interpretation. They believe this is a better approach to governance as it provides clarity to the

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[158] US Department of the Treasury – Press Release: http://www.ustreas.gov/press/releases/tg72.htm
[159] Banff Executive Leadership – "Improving Governance Performance – Rules-Based versus Principles-Based Approaches" - "Leadership Acumen" Newsletter – Issue 16, Jan/Feb 2004

organization, auditors and regulators alike. Those opposed to governance regulations structured around rules argue instead that rules cannot account for every possible situation and thus present gaps on specific occasions. They argue that companies and individuals could look for ways around the rules (seeking loopholes). Since every situation cannot be contemplated in advance by regulators, principles-based advocates believe that the intention or spirit of regulation is more important.

Principles-based approaches seek to identify the proposed goal of regulations and then develop a series of best practices to use as exemplars and provide guidance for behaviour. This perspective on governance would allow individual organizations to interpret the best way to achieve their desired end results and encourage them to develop mechanisms pertinent to their specific organizations. Opponents of this position would argue instead that actors in "actor-network"90 environments seek to take advantage of the overly generalized prescriptions and abuse the discretion given to them. Rules-based approaches thus believe that actors will ultimately ignore the true intent of governance regulations when it serves their purpose to do so.

It is ironic that both sides argue that actors will seek advantage around the rules or the principles to further their own best self-interests. Neither system is without flaws. Rules based approaches are seen as too prescriptive and silent on unforeseen circumstances and therefore open to loopholes and abuse; Principles are seen as too general and therefore open to interpretation and therefore abuse. But by being aware of the inherent weaknesses within each position, both strategies can be worked with in tandem to build solutions that further the goal of good corporate governance.

As we have seem in Section 1, companies and individuals who are intent to breach governance will also do so under both a rules-based or principles-based approach to governance. Similarly, others who try to be models of good governance are also able to be successful under both approaches. There is obviously more to effective governance than simply whether a country or company follows a rules-based approach or follow a principles-based approach to governance.

2.1.7 Importance of the Human side of Corporate Governance:

This review of corporate governance would be incomplete without an exploration into the human dynamics, motives, situations and behavioral circumstances that lead to fraud and breaches in corporate governance. As previously discussed, the majority of governance research to date has focused on the Principle-Agency problem where Agents (employees) could be incented to use the authority given to them by the Principle (owners) to benefit themselves rather than the Principle, as I have outlined in many of the historic breaches of governance outlined in Section 1.1.1. The historic response by owners, investors, regulators and academics has been to introduce additional hard controls to prevent misdeeds including the introduction of new mechanisms of oversight and reporting, affecting Boards of Directors in both parent companies and in their subsidiaries, the focus of this research. In my next section ("The Human Dynamic – Why People Cheat") I will present some recent research on controlling human behaviour that may well give a fresh insight to the issue of fraud and misdeeds and it turn may yield new avenues to approach governance. But before we discuss this, let me explore further the issues of corporate cheating and frauds that permeate within individual firms.

Much research has been done on corporate cheating but none more relevant than that conducted by KPMG's Forensic division for the past two decades. Since 1993, KPMG has published a regular survey of public companies in the United States, Australia, and New Zealand on frauds and related issues. Following on their 1994 and 1998 surveys in the United States, [160] KPMG's forensics division released its third U.S. "Fraud Survey" in 2003. This survey was based on telephone interviews with 459 medium to large sized public companies. Of these, 75% of respondents indicated that they had experienced an incident of fraud in the prior twelve months, 13% higher than the prior survey in 1998. While employee fraud was the greatest single category noted in the 2003 survey, financial reporting fraud had more than doubled since the last survey. Frauds such as theft of assets, cheque fraud, and expense account abuse were the single greatest cost factor for respondents, costing companies an average of $260,000 per incident; one incident of financial reporting fraud cost a company $4 billion.

[160] KPMG Forensic – "Fraud Survey", (2003). See:
http://faculty.usfsp.edu/gkearns/Articles_Fraud/Fraud%20Survey_040855_R5.pdf

The 2003 survey concluded that Factors Contributing to fraud saw an interesting shift. Between 1994 and 2003, there was a decrease in frauds caused by Inadequate Controls from nearly 60% to roughly 40% of surveyed frauds. This may perhaps be explained in part by the new Sarbanes-Oxley processes that would have just been put in place. That said, countering this decline was a noted increase in frauds caused by Collusion between Employees and Third Parties, which grew from approximately 30% to 50%. So while more adequate control measures seem to have produced positive change, the rising figure relative to collusion implies that more sophisticated frauds were being committed. In addition, respondents also reported that frauds in general were on the rise, despite the fact that management was seen as being more diligent and proactive in its prevention and reaction.

KPMG published a glaring insight to the world of fraud in 2008 with "Profile of a Fraudster Survey"[161]. This survey was based on hundreds of actual fraud cases that KPMG had worked on in Europe, the Middle East and Africa. The 2008 report proved to be so popular that KPMG extended their analysis worldwide and, in 2011[162] released a subsequent report in the series entitled "Who Is the Typical Fraudster?" Unlike the 2007 survey on a relatively small number of countries, the 2011 research was based on 348 actual fraud investigations across 69 countries. It was conducted by KPMG between January 2008 and December 2010. While several of the frauds examined in the report attracted considerable public attention, for the most part they were not publicized. These KPMG reports are unique because they focus on the individual, the so-called fraudster, and provide a profile of the perpetrator within the context of the environment in which he operated and the circumstances in which he was located and acted.

The 2007 survey found that the primary motivation for the fraud was greed, followed secondly by pressures to achieve tough business targets for profit and budgets. In 2011 the survey noted that cases of fraud where an individual leveraged weak control structures rose to 74%, up from 49% in 2007. Another interesting shift between the two surveys occurs relative to average length of

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[161] KPMG Forensic – Profile of a Fraudster Survey 2007 - http://www.kpmg.co.uk/pubs/ProfileofaFraudsterSurvey(web).pdf
[162] KPMG International – "Who is the typical Fraudster" 2011 - http://www.kpmgfightingfraud.com/docs/20110601_Profile_of_a_Fraudster_web_accessible.pdf

tenure for people committing fraud. In 2011, the largest portion of fraudsters (33%) had spent more than 10 years in their organization. In 2007, however, most instances of fraud (36%) were committed by people with only 3-5 years of experience in their organization. The KPMG surveys provide an interesting glimpse into the characteristics of a "typical" act of fraud:

• Frauds committed against their own employer	- 90%
• Perpetrators are male	- 85%
• Member of Management	- 84%
• Fraudster acted with others	- 61%
• Offenders with their company more than 5 years	- 60%
• Where external perpetrator was involved	- 48% (suppliers)
	- 22% (clients)
• Frauds were discovered by accident	- 14%

From the above list, we can construct a character profile[163] of the average person committing fraud within the KPMG's global survey range:

- Male
- 36-45 years old
- Commits fraud against his own employer
- Works in Finance function or in a finance related function
- Employed by his company for more than 10 years
- Works in collusion with another perpetrator

By 2011, the average amount lost in each act of fraud[164] (in US dollars) had increased to record high levels. Interestingly these averages also varied by geographic region:

1. Asia-Pacific:	$1.4 million
2. Americas:	$1.1 million
3. Europe & Middle East & Africa:	$0.9 million

Regardless of global location, the findings of the KPMG surveys reveal that there is a significant risk of fraud. The overriding motivations for this instance of "white-collar crime" are greed, opportunity, and pressure to meet budgets. Lone

[163] Ibid, p. 1
[164] Ibid, p. 15

operators represented the greatest risk for companies. These findings are important to review when attempting to develop best practices for corporate governance.

The 2007 KPMG report also highlighted how important it is to examine behavioral factors that are involved in acts of frauds. To this end they developed "The Fraud Triangle" (later expanded to the "Fraud Diamond"). The Fraud Triangle provides a useful framework for understanding the human dynamic that exists when individuals commit fraud. As we examine the "softer" side of governance controls, it is useful to understand the human and situational factors that produce fraudulent behaviour. The three components of the KPMG Fraud Triangle[165] are:

- **Opportunity:**
  Generally occurring due to weaknesses in control systems, opportunity is what allows a person to believe an act of fraud is likely to be successful and remain undetected
- **Motive:**
  While the reasons behind a fraudulent act can vary widely and include dispositions like arrogance or feelings of superiority, the typical perpetrator's motive is based on an excessive life-style (that may include gambling, drug or alcohol abuse or expensive tastes) or a feeling of being improperly compensated for roles and responsibilities;
- **Rationalization:**
  In order for an act of fraud to be committed, the perpetrator must be able to justify their actions to themselves

These three dynamics deserve further review, and I propose that it would be best to do so in the context of the work by Wolfe and Hermanson.[166] These authors expanded on the KPMG Fraud Triangle by adding a fourth consideration: **Capability.**

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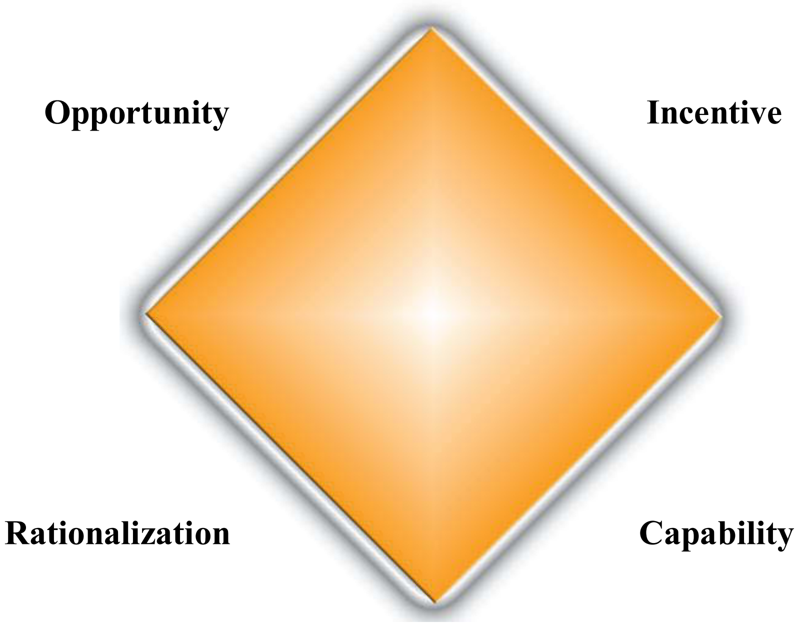
[165] KPMG Forensic – Profile of a Fraudster Survey 2007 - http://www.kpmg.co.uk/pubs/ProfileofaFraudsterSurvey(web).pdf
166 The Fraud Diamond: Considering the Four Elements of Fraud – CPA Journal Dec 2004 - David T. Wolfe / Dana R. Hermanson

According to Wolfe and Hermanson, this is the unique professional and psychological dynamic of the person willing and able to commit fraud. Wolfe and Hermanson's model expands on KPMG's original triad and encapsulates the fraudster's thought processes in the following manner:

- Incentive: "I want to, or have a need to, commit fraud"
- Opportunity: "There is a weakness in the system that the right person could exploit"
- Rationalization: "I have convinced myself this fraudulent behavior is worth the risks"
- Capability: "I have the necessary traits and abilities. I can pull this off"

Figure 3
Wolfe & Hermanson's "FRAUD DIAMOND"



(Source: D. Wolfe & D. Hermanson - 2004)

Capability highlights important personal and professional traits of the fraudster and provides researchers insight into additional ways that controls or governance processes need to be effective. According to Wolfe and Hermanson, "capability" characteristics of the fraudster included:

- Position: The fraudster's position or function in the company may furnish the ability to create of exploit an opportunity for fraud;
- Intelligence: the fraudster is smart enough to exploit internal control weaknesses According to the Association of Certified Fraud Examiners:
  - 51% of perpetrators of occupational fraud had at least a bachelor's degree;
  - 49% of the fraudsters were over 40 years old;
  - 46% of the frauds were committed by managers or executives;
- Strong Ego: the fraudster has a confidence that they will not get detected, or he could talk his way out of trouble if caught
- Persuasive: a successful fraudster can coerce others to commit fraud, through persuasion, bully tactics, or "cultivating fear rather than respect";
- Liar: the successful fraudster lies effectively and consistently to avoid detection;
- Stress: the successful fraudster deals well with stress.

This analysis shows marked consistency with the research performed in the KPMG studies that demonstrate how white-collared crimes are often perpetrated by senior, experienced, and trusted insiders who are confident and capable of executing fraud within an organization. As the preventative mechanisms to fraud are explored in this book, it is important to keep these more human dynamics in mind. This is especially true relative to Hilb's model of new corporate governance and Hofstede's model for managing across cultures and international subsidiaries. In order to achieve success in corporate governance (especially governance of international subsidiaries), addressing the social dynamics is of critical importance.

The Human Dynamic – Why People Cheat

As discussed at the beginning of this review on the "Human Side of Corporate Governance", another dimension to the situational processes behind fraud is the behavioural research performed by Dan Ariely. Ariely studied agency theory in his book *Predictably Irrational: the Hidden Forces That Shape Our Decisions*[167]

[167] Ariely, D - "Predictably Irrational: the Hidden Forces That Shape Our Decisions", 2008, HarperCollins

and concluded that people who cheat have two goals: to feel good about themselves, and to achieve personal gain.

Between these two potentially conflicting goals there exists a balance that Ariely calls the *fudge factor*: people will cheat up to the level that they still feel good about themselves. Ariely's research focuses on the ability to shrink or grow the fudge factor, which essentially entails the degree that one could influence the behaviour of people who are willing and able to cheating, by manipulating or shifting the balance between personal gain and moral satisfaction. Although seemingly divorced from the world of international subsidiaries, the ability to deter people from cheating has crucial implications for any efforts at increasing effective corporate governance.

In his research, Ariely gave a test to groups of UCLA students and told them that they would be paid for every correct answer they scored. The first groups of students were told to self-grade the exam, then to destroy the exam papers and to self-declare (personal gain) how many correct answers they had. Empirical evidenced demonstrated that cheating occurred within these groups given the opportunity to cheat and the nature of the benefit. The next groups were asked to first recite the Ten Commandments (moral reminder) before they took the test. Results demonstrated that the ethical implications contained within the Ten Commandments increased one's sense of self and consequently shrunk the fudge factor completely; there was no cheating at all. They concluded that this was not a religious principle because self-declared atheists were included in the study. The test demonstrated that reminding people of their own moral standards was enough to curb cheating behaviour.

Also especially relevant to my research are Ariely's observations on the impact of monetary and nonmonetary benefits. From another study involving students, Ariely found that people would take cans/bottles of Coca-Cola temptingly placed in University residence refrigerators but would not touch any $1 bills left on plates in similar locations. During an interview at a TED[168] Conference in 2009, Ariely explained that[169]:

> **"When you take a pencil, for example from work, there's all kinds of stories you can tell yourself. You can say this is something everybody does. Or, if I take a pencil home, it's actually good for work because I can work more. It's the same thing with the Coke. You can say to yourself, maybe somebody left it on purpose, or somebody took mine once so it's okay for me to take this. When you take money, you can't help but think you're stealing."**

Other experiments explored the notion of taking the presence of money away to see if it enticed individuals to cheat:

> **"We did the experiment with tokens instead of money to see if it would change the cheating and it did. The idea was we get people one step away from money, and they cheat more. As we deal with things that are more distant from money, the easier it is to cheat and not to think of yourself as a bad person. I think we're moving to a society where things are getting more and more removed from cash. Executives backdating stock options can think it's not cash, it's stock options".**

In that same interview Ariely also suggested that cheating can become a social norm in an organization:

> **"Take what happened in Enron. There was partly a social norm that was emerging there. Somebody started cheating a little bit, and then it became more and more a part of the social norm. You see somebody behaving in a bit more extreme way, and you adopt that way. If you stopped and thought about [what you were doing] it would be clear it was crazy, but at the moment you just accept that social standard. The second thing that happened at Enron is that it wasn't clear what was the right social norm to apply to this particular emerging energy market. They could basically define it anyway they wanted. And, finally, they were dealing with stuff that was really very removed from money, which allowed them to [cheat].**

Ariely's research makes it clear that an understanding of the human dynamic is fundamentally relevant to any analysis concerning the occurrence of fraud. What then are the implications of human dynamics on the mechanisms that promote

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[168] TED (Technology, Entertainment and Design) is a global set of conferences owned by the private non-profit Sapling Foundation, formed to disseminate "ideas worth sharing."

[169] Zetter, K. (2009). "TED: Dan Ariely on Why We Cheat", Wired Magazine, Feb 7, 2009, See: http://www.wired.com/epicenter/2009/02/ted-1/

good corporate governance? According to Ariely, people need to be focused on morally good behaviour and given opportunities to see themselves as if they are looking in a mirror. Increasing the conscience of actors in the principal-agency conflict and reminding people of moral principles actually helps shrink the fudge factor that allows humans to cheat. So how can this be achieved in organizations? The same underlying principles apply, of course, but in business today it is more often the case that moral mechanisms are wrapped in corporate values, culture, and codes of conduct. This strategy is especially prevalent in Canadian banks, a factor that may be heavily responsible for their ability to avoid corporate governance scandal and fraud.

We will return to these themes later. But now let's bring this discussion into the context of my research. In the next section I would like to introduce the reader to the world of Canadian banking with a particular focus on the international networks of these Canadian banks. My attention focuses on Canada's five largest national banks which are all active internationally and all following different strategies.

2.2 International Canadian Banks:

2.2.1 Legal and Regulatory Context for Corporate Governance of Canadian Banks:

2.2.1.1 Introduction

In 2011, 77 banks[170] were licensed to do business in Canada. 101 Within Canada there are three levels of banking licence that differentiate domestic banks from foreign banks and delineate the activities that the latter are permitted to do when opening branches (rather than subsidiaries) in Canada. The three categories are referred to as Schedule I, Schedule II and Schedule III banks. Schedule I and Schedule II banks are fully licensed deposit and lending institutions that "may be eligible for deposit insurance protection for their depositors." Schedule III licences, in contrast, have been created especially for foreign banks that wish to operate in Canada as a branch of their parent organization, with limited or

[170] Canadian Banker's Association – 2011 Brochure "Expertise Canada Banks On" – p5

restricted activities. Table 7 provides a breakout of the Schedule I, II, and III licences that were granted in Canada during 2012.

This dissertation focuses on Canada's five largest domestic banks and their attempts to ensure good corporate governance across their network of international subsidiaries. Of the 77 banks licensed to do business in Canada, the five biggest domestic institutions operate 85% of the 6,100 branches in Canada. They are also the only banks that provide domestic retail banking across all three coasts (Atlantic, Pacific and Arctic) and cover every province and territory. These banks also have substantial international networks, with subsidiaries spanning between 11 (Toronto Dominion Bank) and 56 (Scotia) countries.

Table 7: Banks in Canada - 2011[171]

Type of Bank	# in 2011	Purpose:	Regulator:
Schedule 1	23	Domestic Banks – national financial institutions that are allowed to take deposits and are not subsidiaries of a foreign bank.	Federal Bank Act
Schedule 2	25	Foreign Banks – subsidiaries of international financial institutions that are authorized to take deposits in Canada.	Federal Bank Act
Schedule 3	29	Foreign Banks – branches of foreign institutions that are permitted to do restricted business in Canada.	Other Acts (e.g. Corporations Act)

(Source: derived from The Canadian Banker's Association)

The "Big 5" Banks

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The "Big 5" banks in Canada, listed by size, are: Royal Bank of Canada (RBC), Toronto Dominion Bank (TD), Bank of Nova Scotia (Scotia), Bank of Montreal (BMO), and Canadian Imperial Bank of Commerce (CIBC). By international standards these banks are considered large and well-capitalized. They all have long and successful histories, stemming back nearly 200 years to 1817 when the

[171] ibid

Table 8: Comparing Canada's Top 5 International Banks (as at: Oct 31, 2012)

Comparing Canada's Top 5 International Banks (Source: Bank Annual Reports as at Oct 31. 2012 - $ Canadian)				
Bank	**Statistics**	**Board of Directors**	**International Presence**	**Main International Focus:**
Royal Bank of Can.	Assets: $825 billion Net Income: $ 7.6 billion Can Branches: 1,200 WW Employees: 80,000 # Clients: 15 million Year Founded: 1864	Board Size: 17 # Independent: 16 # Foreign Directors: 2 # Foreign Countries: 1	Countries: 56 % Net Income: 33% Main Locations: US, UK & Caribbean (17 countries)	US/UK – Capital Markets Caribbean Banking – 127 br.'s UK/Caribbean – Wealth Mgmt Barbados – Reinsurance 1st Office: 1882 - Bermuda
TD Bank	Assets: $811 billion Net Income: $ 6.5 billion Can Branches: 1,100 WW Employees: 70,000 # Clients: 20 million Year Founded: 1855	Board Size: 15 # Independent: 14 # Foreign Directors: 5 # Foreign Countries: 1	Countries: 11 % Net Income: 36% Main Locations: US, UK	US Retail banking – "more branches in US than Can." US/UK – Capital Markets 1911 – London, England
Bank of Nova Scotia	Assets: $668 billion Net Income: $ 6.5 billion Can Branches: 1,019 WW Employees: 75,000 # Clients: 19 million Year Founded: 1831	Board Size: 13 # Independent: 12 # Foreign Directors: 3 # Foreign Countries: 2	Countries: 60 % Net Income: 43% Main Locations: US, UK, Latin America, & Caribbean	Largest Bank in Latin America 46,000 Int'l employees 52% of employees = Spanish "Canada's 1st Int'l Bank" 1885 US; 1889 Jamaica
Bank of Montreal	Assets: $525 billion Net Income: $ 4.1 billion Can Branches: 933 WW Employees: 46,000 # Clients: 12 million Year Founded: 1817	Board Size: 14 # Independent: 13 # Foreign Directors: 3 # Foreign Countries: 1	Countries: 25 % Net Income: 11% Main Locations: US Branches in US: 638	US – Wealth Management US – Retail Banking US/UK – Capital Markets
CIBC	Assets: $393 billion Net Income: $ 3.3 billion Can Branches: 1,000 WW Employees: 42,000 # Clients: 11 million Year Founded: 1867	Board Size: 15 # Independent: 14 # Foreign Directors: 3 # Foreign Countries: 1	Countries: 24~ % Net Income: 25% Main Locations: Caribbean, US	Caribbean – Retail banking US/UK Capital Markets

Bank of Montreal was formed. In particular these banks, and the regulatory regime that they operate in, have given Canada the WEF's raking for having the "soundest" banking system in the world.

Table 8 on the following page presents summarized data on the financial dynamics, board structure, and international presence for the "Big 5" from their 2011 annual reports (as of October 31, 2011). Within Canada's domestic market these banks are seen to be relatively similar in products and services. However, as we focus attention on their international strategies and dynamics we start to see how vastly different these banks actually are.

In fact, it is these differences in their international strategies and structures that provide a rich body of material to analyze and their approaches to corporate governance of their international subsidiaries. The particular similarities and differences between these institutions will be explored in greater detail in Section 3 (Specific Empirical Part). Before doing so, however, it will be helpful to first understand these banks as a group and the regulatory environment in which they operate.

Universal Banking in Canada's "Big 5" Banks

Canada's Big 5 banks are all considered universal banks. Benson describes universal banks as "Financial institutions who may offer the entire range of financial services." In addition to traditional deposit and lending services that most consumers would easily recognize, according to Benson102 universal banks "may sell insurance, underwrite securities, and carry out securities transactions on behalf of others." So while each bank is individually configured, they all offer the same range of core financial products. In examining these banks and using RBC[172] as an example we will see the range of products offered by its operating division. This will provide excellent insight into the typical breadth of services offered by domestic banks in Canada:

- **Canadian Banking:**
  All banks offer a full range of consumer and business services. Deposit accounts and lending products like mortgages are included in this mix.

[172] Royal Bank of Canada – 2011 Annual Report, pp 2-4

Table 9: Canada's National Regulatory Framework for Financial Services

Type of Institution	Prudential Regulation	Market Conduct Regulation
Bank	Office of the Supervisor of Financial Institutions (Federal)	Financial Consumer Agency of Canada (Federal)
Trust Company	OSFI or Provincial Financial Institution Regulator	Provincial Regulator for Financial Institutions
Credit Union / Caisse Populaire	Provincial Regulator for Financial Institutions	Provincial Regulator for Financial Institutions
Insurance Company	OSFI/ Provincial Financial Institution Regulator	Provincial Financial Institution Regulator
Securities Dealer	Provincial Securities Commission	Provincial Securities Commission

(Source: Canadian Banker's Association – 2012)

- **Insurance services:**
  All banks offer insurance products to complement their insurable banking (lending and credit) products. In addition, RBC, TD, and now BMO offer a full range of insurance products through operating subsidiaries in Canada.

- **Wealth Management services:**
  All banks offer personal trust services, personal financial planning, brokerage and advisory services, mutual funds and discretionary investment management. RBC in particular is also well developed in and respected for its international private banking services.

- **Capital Markets:**
  All banks offer investment banking services for merger and acquisitions, fixed income and equity trading, foreign exchange and currency market activities, and other treasury and cash management activities.

Table 10: Canada's Regulatory Framework for Financial Institutions

Jurisdiction	Prudential Regulator	Market Conduct Regulator	Securities Regulator	Insurance Regulator
Canada	OSFI	FCAC		
Alberta	Alberta Finance, Financial Institutions	Alberta Ministry of Government Services, Consumer Services Division	Alberta Securities Commission	Alberta Insurance Council *)*
British Columbia	Financial Institutions Commission (British Columbia)	British Columbia Ministry of the Attorney General, Community Justice Branch, Consumer Services Division	British Columbia Securities Commission	Insurance Council of British Columbia *)*
Manitoba	Manitoba Consumer and Corporate Affairs	Manitoba Consumer & Corporate Affairs, Consumers Bureau	Manitoba Securities Commission	Insurance Council of Manitoba *)*
New Brunswick	New Brunswick Department of Justice	New Brunswick Department of Justice, Consumer Affairs Branch	New Brunswick Securities Commission	Superintendent of Insurance, (Department of Justice, Insurance Branch)
Newfoundland	Newfoundland Department of Government Services	Newfoundland Department of Government Services & Lands, Consumer & Commercial Affairs	Securities Commission of Newfoundland & Labrador	*(same as prudential regulator)*
Nova Scotia	Nova Scotia Department of Environment & Labour, Financial Institutions Section	Nova Scotia Department of Business & Consumer Services	Nova Scotia Securities Commission	Superintendent of Insurance, Department of Environment and Labour
Ontario	Financial Services Commission of Ontario	Ontario Ministry of Consumer and Business Services, General Enquiries Unit	Ontario Securities Commission	Financial Services Commission of Ontario/SRO
Prince Edward Island	Prince Edward Island Ministry of the Attorney General, Consumer, Corporate and Insurance Division	*(same as prudential regulator)*	*(same as prudential regulator)*	*(same as prudential regulator)*
Québec	Autorité des marchés financiers	*(same as prudential regulator)*	*(same as prudential regulator)*	Chambre de l'assurance de dommages, Chambre de la sécurité financière
Saskatchewan	Saskatchewan Financial Services Commission	*(same as prudential regulator)*	*(same as prudential regulator)*	Insurance Council of Saskatchewan
Northwest Territories	Northwest Territories Department of Finance	NWT Municipal & Community Affairs, Community Operations Programs, Consumer Services	Registrar of Securities, Northwest Territories	Superintendent of Insurance
Nunavut	Nunavut Department of Justice	Nunavut, Department of Community Government & Transportation	Registrar of Securities, Nunavut	Superintendent of Insurance, Department of Finance/Fiscal Policy & Taxation
Yukon	Yukon Department of Justice, Corporate Affairs & Registrar of Securities	Yukon Department of Justice, Consumer Services Branch	*(same as prudential regulator)*	Superintendent of Insurance, Department of Justice

(Source: Canadian Banker's Association – 2012)

- **International:**
  As outlined in Table 8, the "Big 5" all have material components of their business operating in international affiliates and subsidiaries. Relative to the 2011 annual reports from each bank, the amount of net income generated outside of Canada ranges from 11% to 43%. It is important to note that the percentage of net income generated outside of Canada has grown each year and is expected to continue to grow (See Section 3 – Empirical Part: 3.6.1 Findings and Observation) in the years ahead.

Within Canada, the Big 5 banks all offer a wide range of financial services. As banks they all operate under a national bank charter and are governed by national regulators for both prudential and market conduct affairs.

Since these banks offer a wide range of other services to customers in every province and territory in Canada, they are equally subject to a number of other federal and provincial/territorial regulators. Table 9 provides an overview of Canada's regulatory framework for financial institutions.

Later sections of this dissertation will delve further into the specific components of regulatory frameworks at the national level. At this point, however, it is necessary to understand first how the provincial and territorial regulatory frameworks operate within the overall regulatory regime for financial institutions in Canada. Table 10 highlights the jurisdictions and specifications of this provincial and territorial framework.

We now turn our attention to specific pieces of Federal regulation that guide Canada's Banks.

2.2.1.2 The Bank Act (Canada)

Banking in Canada falls under the authority of the Federal Government. This jurisdiction was established at the time of Canada's birth as a nation with the passage of *The British North America Act, 1867* (BNA). The BNA Act was subsequently renamed in 1982 when Queen Elizabeth II signed *The Constitution*

Act, 1867 (otherwise known as "The Canadian Constitution"[173]) and granted Canada independence from the United Kingdom. Following the authorities in the original BNA Act, the new constitution also empowered the Federal Government of Canada with responsibility for all banking activities in Canada.

The Bank Act, first passed in 1871, gives the laws and processes for banking practice in Canada. Its three primary goals[174] are: "protecting depositors' funds; insuring the maintenance of cash reserves; and promoting the efficiency of the financial system through competition". The Act is reviewed and updated every 10 years for current trends as well as environmental and technological changes. While this pre-determined schedule of review provides reasonable stability of regulation during the ensuing 10-year period, minor modifications or clarification can occur during the interim.

Responsibility in the Canadian parliament for the *Bank Act* falls to the Minister of Finance. This position carries the highest authority for monitoring the effectiveness of the Act and granting rulings and exceptions. It is the Minister of Finance who revises and updates the *Bank Act* with assistance from the Minister of Justice, who bears responsibility for drafting, publishing, distributing, and defending the laws of the land. In addition to the Minister of Finance, the Cabinet of the federal government also has certain authority relative to banking; their role is defined as Governor in Council.[175]

It is important not to confuse the *Bank Act* (of Canada) with the *Bank of Canada Act*.109 The latter is the federal Act that gives the Bank of Canada (Canada's central bank or treasury) its powers and authorities. In that sense, the *Bank Act* regulates Canadian banks while the *Bank of Canada Act* defines the responsibilities of the central bank of Canada.

Bank of Canada (Canada's Central Bank)

The Bank of Canada plays a crucial role at the national level by setting monetary policy and interest rates, managing currency and liquidity, and overseeing the

[173] Government of Canada – "The Constitution Act, 1867", Section 91(15) pp 30-31
[174] The Canadian Encyclopedia – "Bank Act" – See: http://www.thecanadianencyclopedia.com/articles/bank-act
[175] Government of Canada – "The Bank Act, S.C. 1991, c.46", Section 2.4(1) p. 12

macro-economic and financial system in Canada. Although the central bank in Canada is not the chief banking regulator for this country, it does interact with particular banks in Canada and represents Canada's interests at international banking conferences and gatherings.

In my interview with the CEO of the Canadian Banker's Association[176] I was advised that the Bank of Canada is not a regulator in the same sense as OSFI (which sets capital levels, oversees bank risk management practices, prudential standards etc.). But they are very much involved in discussions to ensure that the banking industry is safe, sound, and strong. The Bank of Canada looks at the macroeconomic perspectives of the Canadian economy, i.e. impact on the economy as a whole; whereas OSFI is micro, i.e. institution-specific.

The Bank of Canada has a number of roles that affect individual banks: it is the lender of last resort for banks, i.e. the ultimate liquidity provider; it has an interest in systemic payment systems (e.g. the Large Value Transfer System) and in this capacity, it chairs the Canadian Payments Association; it calls on banks to provide data to it so that it can monitor trends etc.; it is also deeply involved in regulatory design and implementation, both as a member of Ministry of Finance's Financial Institutions Supervisory Committee (made up of the Ministry of Finance, OSFI, the CDIC, the Central Bank, and the Financial Consumer Agency of Canada) and as part of the Financial Stability Board and Basel Committees internationally.

So while the Bank of Canada, as the central bank in Canada, is deeply involved in regulation, it is not a regulator per se. This is in contrast to some countries (e.g. the UK, the US), where the central bank is also the prudential regulator.

This clarification reveals the distinct role that the Bank of Canada plays in this country. With this in mind, it is useful to examine the prudential regulatory role of the Office of the Superintendent of Financial Institutions (OSFI), which is Canada's national regulator and supervisor of financial institutions. Like the Bank of Canada, OSFI is an independent agency that also reports to the Canadian Government through the Minister of Finance.

[176] Campbell, T. - Canadian Banker's Association – in an e-mail dated: March 16, 2012

Office of the Superintendent of Financial Institutions (OSFI)

The "Office of the Superintendent of Financial institutions" (or OSFI) is the single banking regulator in Canada. The *Bank Act* gives OSFI its authority and requires that all banks provide information as it is required by this agency. The Bank Act also allows OSFI to issue criminal sanctions for noncompliance with banking laws. The safety and soundness of financial institutions in Canada is its key role. Headed by the Superintendent of Financial Institutions, OSFI has regulatory and supervisory authority over other "federally regulated deposit taking-institutions, insurance companies, and pension plans[177]".

OSFI is regularly referenced in the Bank Act in its capacity as chief regulator of banks. Despite this, OSFI's objectives and responsibilities are obtained from its own statute, the Office of the Superintendent of Financial Institutions Act[178]. Under this legislation, OSFI's mandate[179] is to:

- Supervise institutions and pension plans to determine whether they are in sound financial condition, meeting minimum plan funding requirements, and complying with their governing law and supervisory requirements
- Promptly advise institutions and plans in the event of material deficiencies that require management, boards or plan administrators to take corrective measures expeditiously
- Advance and administer a regulatory framework that promotes the adoption of policies and procedures designed to control and manage risk
- Monitor and evaluate system-wide or sector-based issues that may impact institutions negatively

To achieve these goals, OSFI uses several measures, including meeting with the bank boards and senior management, reviewing bank financial statements and other documents, conducting on-site audits, and ensuring that various measures of capital adequacy, risk-based measurements processes and other standards (like codes of conduct) are in place. These reviews are conducted on a consolidated basis and carried out through a combination of on-site and off-site audits. OSFI

[177] OSFI – See: http://www.osfi-bsif.gc.ca/osfi/index_e.aspx?ArticleID=3
[178] Government of Canada - "Office of the Superintendent of Financial Institutions Act (R.S.C., 1985, c. 18 (3rd Supp.))"
[179] OSFI Web site – "OSFI Mandate" – See: http://www.osfi-bsif.gc.ca/osfi/index_e.aspx?DetailID=2

meets with key bank officers and management on a regular basis. Another key principle of the supervisory framework is the process of reliance on external auditors, which enables OSFI to review the working papers of external auditors in support of their own annual audit of banks' financial statements.

During their reviews, OSFI looks to ensure that several key elements of prudentiality are in place. For example, Canadian banks are required to comply with the capital adequacy requirements established in the Basel Accord. Due to the complexity of these businesses, OSFI subsequently employs a risk-based methodology to evaluate an institution's risk profile, financial condition, risk management processes, and compliance with applicable laws and regulations. OSFI's supervisory framework seeks to ensure that:

- Banks annually perform a self-assessment of their adherence to the CDIC Standards of Sound Business and Financial Practices.
- Banks monitor their concentration of credit risk exposures to single borrowers or groups, to 25 percent of regulatory capital.
- Banks maintain information systems that can identify the concentrations of risk and follow the OSFI's Prudent Person Approach to manage risk-related issues in investment and loan portfolios.
- OSFI validates bank "value-at-risk" models for reporting market risk capital; such models accurately measure, monitor and control market risks.
- Banks and OSFI perform stress-tests for risk and other contingency plans.
- OSFI ensures that banks have internal controls in place that are adequate for the nature and scale of their business. Internal control policies and procedures need to be approved by a bank's board of directors and assessed by an independent internal audit on an annual basis.
- OSFI evaluates the quality of risk management for each significant activity in which the bank is engaged. This includes assessing board oversight and senior management in order to generate an overall evaluation of the quality of risk management. Liquidity risk, interest risk and operational risk need to be specifically identified to ensure that banks have adequate liquidity contingency plans in place.

- OSFI expects banks to have codes of conduct in place to ensure that employees are dealing with customers on an ethical basis. Processes and training procedures regarding money laundering detection and escalation procedures are also examined in this regard.

A crucial point of interest relative to research on corporate governance in international subsidiaries is OSFI's mandate to review banks on a consolidated basis. In some cases, OSFI will extend its supervisory powers to include a nonbanking corporate body of a bank if its activities are deemed to carry a significant risk profile to the consolidated group. This includes domestic and foreign operations and the activities of subsidiaries and affiliated companies of a given bank. In support of this, the Bank Act requires that all banks provide OSFI with access to records of controlled subsidiaries and authorize the Superintendent to enter into agreements with foreign regulators in this regard.

Through its audits, reviews and risk assessments, OSFI plays an active role in the oversight of every Canadian bank by following a risk-based approach to its reviews and analysis. What is especially interesting to note is that OSFI's legislation explicitly recognizes the need for financial institutions to compete effectively and take reasonable risks. Yet this legislation also recognizes "that management, boards of directors and plan administrators are ultimately responsible and that financial institutions and pension plans can fail."114 This presents a conflict, however, because the freedom given to financial institutions to compete effectively and take risks in the global marketplace is precisely what often leads them to fail. OSFI's mandate to monitor and supervise financial institutions on behalf of the public good subsequently creates an interesting relationship between the regulator and the banks. For as both the United States and the United Kingdom have recently shown, regulators come under severe scrutiny when banks fail but are never complimented when banks make unexpectedly high profits. This is an interesting dichotomy for OSFI.

All national regulators struggle with the conflict between competitiveness and effective regulatory practices. In the UK, for instance, the Bank of England noted in its Financial Stability Report for June 2010[180] that:

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[180] Bank of England, "Financial Stability Report", June 2010, Box 7, p58

> **"History suggests, however, that financial crises have often been extremely costly, with significant output losses and scarring effects that permanently reduce the level of output. For example, the IMF estimates that output remains 10% below its pre-crisis trend seven years after the start of a typical systemic crisis. So even if the probability of crises can be reduced slightly, the potential gains would be large. And there might be additional welfare benefits deriving from greater stability in a regime with less frequent crises."**

The notion that the "cost of regulation" is ultimately less than the "cost of crisis" leads nations and regulators to consistently follow each financial crisis with new and stricter regulations. In effect, this trajectory underscores the observation made earlier that regulation follows crisis.

As a follow up to the Bank of England's June 2010 FSA report, Her Majesty's Treasury in July 2010 published: "A new approach to financial regulation: Judgement, Focus and Stability"[181]. This document proposed regulatory reforms to the tripartite model of the Bank of England, the Financial Services Authority (FSA) and the Treasury, by creating a yet newer agency called the "Financial Policy Committee" within the Bank of England to better oversee and coordinate the various responsibilities of the UK regulatory environment and strengthen the need for balance between competitiveness and prudential regulation.

At that same time in the United States regulators were also evaluating the balance between competitiveness and regulation and concluded by introducing the Dodd-Frank Wall Street Reform and Consumer Protections Act[182] ("Dodd-Frank") into law in July 2010. Having similar goals to the proposed changes in the United Kingdom, Dodd-Frank was the most significant financial reform in the United States since the Glass-Steagall (Bank Act) that followed the 1929 stock market crash. (For details on Dodd-Frank see Section: 2.1.4 Global Guidelines.) Although the United Kingdom and United States reforms were the most prominent, other countries (such as China[183]) that were not materially affected by the global financial crisis were also examining better ways to balance the need between competitiveness and effective regulation.

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[181] HM Treasury: "A new approach to financial regulation: Judgement, Focus and Stability", p. 4
[182] Dodd-Frank Act - http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf
[183] Lau, L.J. – "Financial Regulation and Supervision Post the Global Financial Crisis" – Chinese University of Hong Kong, Sept 2010, pp 1-2

All regulators struggle to find the right balance between competitiveness and regulation. We note that Canada is one of the few countries that came through the global financial crisis relatively unscathed and continues to be rated by the World Economic Forum as the soundest banks in the world. To appreciate how this was possible, we must also understand the role played by the regulator and the regulatory environment in Canada in achieving these results.

OSFI's stated goal is to ensure competitiveness and prudent regulatory practices for all financial institutions in Canada. This is a difficult set of conflicting goals in today's dynamic and global financial arena where change occurs daily. Nevertheless, it is clear that OSFI has achieved their goal, at least relative to the most recent banking crisis and as viewed by the World Economic Forum. So in spite of the difficulties faced in Canada during the recent years, OSFI as a regulator must be given some credit for the success Canadian banks have experienced over the past decade. We will be examine the role that OSFI and the regulatory framework played in the success of Canada's banks in much greater detail in Section 3 – Empirical Part.

Let me now present the other key regulators that also have direct oversight responsibility for Canada's banks, starting with Canada's securities regulators.

2.2.1.3 Securities Laws and Regulators in Canada

Unlike most other nations, Canada has delegated regulatory authority for securities law to each of its ten provinces and three territories (Table 10). The authority to oversee securities and capital markets activities was given to provinces in the British North America Act (1867) and subsequently enshrined in the Canadian Constitution (1982). From the perspective of an effective regulatory framework, this is now seen by many[184] as an error of history. The federal Minister of Finance proposed the creation of a single national securities regulator in Canada – not unlike the Securities and Exchange Commission (SEC) that exists in the US – to consolidate the authorities of the individual provinces and territories. The proposal was controversial and eventually went to the Supreme Court of Canada for a ruling in 2011. Opinions on the debate were quite divided.

[184] CBC News – "Why is a national securities regulator so controversial?" – Dec 22, 2011, See: http://www.cbc.ca/news/canada/story/2011/12/22/f-federal-securities-agency.html

Proponents say that a single securities regulator would be more comprehensive and effective than the current regime of thirteen separate regulators with varying rules and perspectives. They also argue that it would result in stronger regulatory enforcement and a reduction in white-collar crime. The Minister of Finance's proposal had powerful supporters, such as the Ontario Securities Commission (which is seen as the leading securities commission in Canada), many provinces, and "much of the Canadian business community, including the Canadian Bankers Association, as well as international bodies like the Organization for Economic Cooperation and Development (OECD) and the International Monetary Fund (IMF)"[185].

That said, several powerful groups are against the proposal to create a single national securities regulator in Canada. This side of the debate includes the governments and powerful securities commissions that exist in Quebec and Alberta because they "don't want to lose control over their local economies to a federal agency"[186]. Of important note is the fact that Quebec has attempted twice to separate from Canada (in 1980 and 1995); both referendums were only narrowly defeated (by 60% and 50.4% respectively). This demonstrates the strong cultural sentiments felt in that province, which sees Quebec as a distinct nation, so it is possible that any loss of provincial authority is seen as compromising the separatist sentiment. While proponents of good corporate governance see a single securities regulator as a positive move, any debate that proposes a shift of existing provincial powers or authorities away from the provinces to a Canadian national agency becomes a very emotional and highly political discussion.

In a unanimous decision, the Supreme Court of Canada ruled in December 2011 that the Minister of Finance's proposal for a single national securities regulator in Canada was unconstitutional, saying that "overseeing of capital markets is primarily a provincial matter"[187]. This ruling means that Canadian national banks must all be registered and in compliance with each of the 13 provincial and territorial securities regulators. This is cumbersome but it is the law.

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185 ibid
186 ibid
187 Business Week – "Canadian Court Says Single Regulator Unconstitutional" Dec 23, 2011, See: http://www.businessweek.com/news/2011-12-23/canadian-court-says-single-regulator-unconstitutional.html

Despite the Supreme Court's decision, most practitioners see the Ontario Securities Commission (OSC) as the lead securities regulator in Canada. This is in part because the Toronto Stock Exchange, which is the leading stock exchange in the country, resides in that province. It is also due to the fact that Ontario contains the largest number of Canadians (34.4 percent of Canada's population) and therefore the largest number of investors that securities commissions are seeking to protect).[188] Most importantly, however, is that the majority of financial and securities institutions, including the Big 5 Banks, all have their headquarters or significant operations in Toronto. In fact, not all issuers or intermediaries in Canada are located in every province and territory. As a result, the OSC oversees the vast majority of financial transactions and activities that take place in Canada. For our review of securities regulators in Canada we will examine in further detail the Ontario Securities Commission.

Ontario Securities Commission (OSC)

The Ontario Securities Commission (OSC) oversees Ontario's capital markets including equities, fixed income, and derivatives markets. It is a Crown corporation that serves as the regulatory agency that administers and enforces securities legislation in Ontario. The Commission reports to the Ontario provincial legislature through the province's Minster of Finance. Set by provincial statute, the mandate of the OSC is to "To provide protection to investors from unfair, improper, or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets[189].

Canadian banks are affected by provincial securities regulators like the OSC in two major ways: first, in their capacity as issuers of securities for capital purposes (including common stock, preferred stock and debt instruments); and secondly, as significant investment and securities businesses that offer products and advisory services to investing customers (including discretionary investment management, mutual funds, advisory brokerage services and capital markets services). All of these products and services in Canada are directly or indirectly supervised and regulated by the securities regulator in the 13 provinces and

[188] Statistics Canada - "Population estimates, age distribution and median age as of July 1, 2011, Canada, provinces and territories", Sept. 2011
[189] Ontario Securities Commission – "About the OSC" – See: http://www.osc.gov.on.ca/en/About_about_index.htm

territories that these banks all operate in. As issuers of securities the Canadian banks need to comply with the securities regulations of the provinces as well as the listing rules of the stock exchanges they are listed on.

For example, RBC's annual report shows that mutual funds—a securities regulated product—are distributed through their Canadian retail banking offices. A similar structure exists for all major domestic banking operations and the Big 5. Like other Canadian banks, the largest emphasis for investments and securities-related services in RBC are in its Wealth Management and Capital Markets business divisions. The description of these divisions is as follows:

> **"Wealth Management comprises Canadian Wealth Management, U.S. & International Wealth Management and Global Asset Management. We serve affluent, high net worth and ultra-high net worth clients in Canada, the United States, the United Kingdom, Asia, Europe, the Middle East and Africa (EMEA) and Latin America with a full suite of investment, trust and other wealth management solutions. We also provide asset management products and services directly to institutional and individual clients as well as through RBC distribution channels and third-party distributors.[190]"**

> **"Capital Markets comprises our global wholesale banking businesses providing public and private companies, institutional investors, governments and central banks with a wide range of products and services. In North America, we offer a full suite of products and service capabilities. Outside of North America, we have a select but diversified set of global capabilities, which includes origination and distribution, structuring and trading, and corporate and investment banking.[191]"**

Note the references to asset management trading, structuring, and investment banking services in these two descriptions. Together, Wealth Management and Capital Markets generated 49.1 percent of RBC's net income in 2011. This concentration underscores the importance that securities-related products and services play within RBC's overall financial success. But since every provider of these products and services is obligated to follow rigid guidelines and have properly licensed advisors, the strength of regulations can have dramatic consequences for the prosperity of Canadian banks. This is especially important

[190] Royal Bank of Canada "Annual Report 2011", p 20
[191] Ibid, p 30

because the importance of securities-related businesses within banks has grown in recent years.

To protect investors, the Ontario Securities Commissions thus requires that representatives in banks (and other companies that offer investment products or advice) are able to demonstrate minimum levels of professional competency before being allowed to offer these products and services to the public. To facilitate the training, development and licensing of professionals in the securities industries, several industry associations have been formed, notably:

- The Investment Industry Regulatory Organization of Canada (IIROC)
- The Mutual Funds Dealers Association (MFD)
- L'Autorité des Marchés Financiers (in Québec)
- The Insurance Councils (for insurance related investments)

The Investment Industry Regulatory Organization of Canada sets the proficiency standards for individuals who sell securities like stocks, bonds, mutual funds, and futures. It also requires that key individuals, such as supervisors, also be licensed. The Mutual Funds Dealers Association provides similar guidance and requirements specific to selling or overseeing mutual funds. At the national level, securities regulatory authorities in Canada jointly formed the Canadian Securities Institute (CSI) to provide securities-related training and accreditation to industry participants. Services vary from selling mutual funds to providing investment advice within a brokerage account or discretionary investment portfolio.

General accreditation requirements for securities-related staff have expanded in Canada and bank employees are regularly studying and taking exams for certification. Failure to obtain a license would prevent employees from participating in these roles and from dealing with the public. Similarly, employees can have their licenses revoked by the Canadian Securities Institute. See Appendix 2 for a list of courses currently being offered by the Canadian Securities Institute for accreditation or licensing purposes.

Securities regulators in Canada play a critical role in overseeing Canada's universal banks, from market conduct and compliance as an issuer to licensing and regulating the behaviours of bank employees who deal with customers. As this element of their business grows, securities regulators are playing an increasingly important role for these banks.

Before we leave the regulatory framework in Canada let's examine a few key points on Canada's *Business Corporations Act* the Act that integrated the 1999 OECD Principles of Corporate Governance into law in Canada in 2001.

2.2.1.4 Canada Business Corporations Act and Bill S-11

The *Canada Business Corporations Act*[192] (CBCA) is an important piece of legislation. The CBCA registers and regulates companies that are incorporated under federal law who can operate nationally without further licensing in any province or territory. The Big 5 banks are licensed under the Bank Act and all operate federally regulated companies, so the CBCA is an additional piece of legislation that they must comply with.

The CBCA played a pivotal role in 2001 when Bill S-11 was passed in Canada. Bill S-11 incorporated the OECD Principles of Corporate Governance and transformed recommended business practice into law for all Canadian companies. This effectively required institutions like banks to change their board dynamics and company processes at the national level.

In the same manner as the King I and II Reports in South Africa and the Kirby Report in Canada, recognizing a broader group of stakeholders has emerged as an influential trend in more recent changes in corporate governance. It is interesting to point out that the CBCA first recognized the need to expand board concern for non-shareholder groups in 1974, long before either of the aforementioned reports. At that time the CBCA[193] specifically identified four groups of potential stakeholders for consideration when considering remedies in disputes among classes of stakeholders including: "Shareholders of a corporation or its affiliates; Current and former directors and officers of the corporation or its affiliates; Directors under the definition of the CBCA; or *Any other person who, in the court's discretion*, is a proper person". This last group in particular opens the

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[192] Government of Canada – "Canada Business Corporations Act (R.S.C., 1985, c. C-44)" - See: http://laws-lois.justice.gc.ca/eng/acts/C-44/

[193] Canada Business Corporations Act, R.S.C. 1985, c-44. Section 238

door to director liability to a broader group of stakeholders and shows that the CBCA was ahead of its time in advocating for broader stakeholder rights.

Although the CBCA was at that time concerned specifically with creating a methodology to resolve disputes stemming from take-overs, the remedies developed covered a much wider range of activities. It legislated, for instance, that courts could decide who qualifies as a "stakeholder" in an effort to particularly target employees or other minority groups that might be mistreated through corporate restructuring. In more recent times within corporate governance, the definition of stakeholder has expanded to recognize not only employees, but also customers, suppliers, and other individuals or entities affected by a corporation's environment or sphere. This broader definition is in clear alignment with the King and Kirby Reports discussed previously.

2.2.2 Corporate Governance of International Canadian Banks and their Subsidiaries:

With this as the backdrop of Canada's regulatory regime for universal banks we can now turn specifically to corporate governance as it relates to Canada's international banks and their international subsidiaries. As demonstrated, Canada's universal banks are actively involved in many lines of financial services that are regulated by various federal and provincial/territorial agencies. For example, as national corporations they are under the jurisdiction of the Canada Business Corporations Act. Their behaviour also falls under the supervision of the Bank Act (described below), which has very detailed requirements concerning the governance, structure, actions and communications of boards. Provincial and territorial securities laws (as described in Section 2.2.1.3) also specify additional requirements for governance and professional conduct for companies that provide investment products and services to the public. Finally, there are other federal and provincial rules for universal banks that offer insurance and trust products.

The regulatory framework in Canada is very comprehensive. But once these companies move into new jurisdictions and attempt to offer similar financial services to the public, they encounter a host of other regulatory structures and pressures from the host country. The bank subsidiary must comply with these in addition to those in place within Canada. Because the operational effects of each location are different, it will be useful to explore these two themes separately.

Corporate Governance of Canada's International Banks in Canada

Corporate governance in Canada is expansive and very detailed. Of the 1,005 sections[194] of law within the Bank Act of Canada, for instance, Part VI (Sections 136-369) is dedicated entirely to corporate governance. Among other things, this section outlines the requirements for companies, boards, management and board committees to act in certain ways and to fulfill certain requirements relative to corporate governance issues. The requirements built into the Bank Act include:

- The requirements for shareholder meetings, the provision of advance information, and voting procedures
- The duties of directors and board committees relative to conflicts, disclosure, bank policies, board size minimums, director qualifications, director elections and tenure
- Requirements for board meetings, such as the minimum number of meetings per year, quorum rules, residency rules, independence requirements, and resolution requirements
- Company by-laws and the rules surrounding them
- Make-up. Purpose and oversight of all committees of the board (such as audit, complaints, and conflicts)
- The authorities of directors and officers, including powers that cannot be delegated
- What classifies as a conflict of interest
- Determining liability, exculpation and indemnification rules
- Change procedures
- Insiders rules and civil remedies

The Office of the Superintendent of Financial Institutions ensures compliance with these corporate governance rules through a number of routine and specific requests for information. The superintendent also performs numerous other

[194] Government of Canada – "Bank Act (S.C. 1991, c. 46)" – See: http://laws-lois.justice.gc.ca/eng/acts/B-1.01/

prudential examinations such as risk evaluations and capital assessments, strategy reviews, board evaluations, and risk, scenario and other stress tests.

Corporate Governance of Canadian Banks in Foreign Jurisdictions

Although the corporate governance laws in many Western countries were designed to achieve many of the same purposes, the specifications of the laws may be quite different between nations (just as Dodd-Frank in the US is different from the Combined Code in the UK). This means that Canadian Banks that expand outside their home jurisdiction consequently also inherit the regulatory and corporate governance requirements of the foreign jurisdictions. Subsidiaries of Canada's international banks in foreign jurisdictions face a corporate governance framework that I call the *4 Pillars of International Subsidiary Governance*:

Pillar 1: Local (international) regulators
Pillar 2: Local subsidiary board of directors
Pillar 3: Bank main board of directors
Pillar4: Canada's national regulators

Cultural nuances also play a critical role in the success of a subsidiary (See Section 2.3.3). From the perspective of corporate governance, Canadian banks operating in foreign jurisdictions experience increased complexity for their day-to-day operations and possibly even conflicts of governance. For example, what if it is the local custom to offer bribes to officials to expedite the issuance of banking licenses when paying bribes is against the law in Canada? How should the Canadian bank respond? As Canadian banks expand into foreign jurisdiction they will need to be prepared for unexpected surprises of practice and regulation that may be unique to that host jurisdiction.

Pillar 1 of Subsidiary Governance: Local (International) Regulators

As examined previously (Table 7), each of Canada's Big 5 banks have significant international presence today. Some banks have an international history that stems over 100 years. The Bank of Nova Scotia[195] and RBC[196] for instance, opened their first international offices in the late 1800's. Scotia opened its first international offices in Milwaukee in 1885 and in Jamaica in 1889, while RBC opened its first international office in Bermuda in 1882 (See Figure 4). Why would these Canadian institutions be active in foreign locations so early? As Trevor Carmichael's book *Passport to the Heart*[197] chronicles, trade and business flows required Canadian banks to provide credit services to Canadian customers who were importing and exporting internationally. Throughout the Caribbean, for example, both Scotia and RBC were providing credit facilities on behalf of Canadian importers who were bringing sugar and rum into Canada and exporting salt fish, lumber and other raw materials into the Caribbean[198].

Today both Scotia and RBC are in over 50 countries and the Big 5 have moved beyond their initial roots in credit services and are active internationally in the capital markets, wealth management and international reinsurance sectors. They also operate robust domestic retail banking networks in foreign countries.

The fact that the environment has changed significantly since the early days of banking in Canada is important relative to corporate governance because banks now need to comply with an array of international regulators.

Among their responsibilities, the parent boards and the directors of each subsidiary have an obligation to the local regulators in the countries in which they operate which in my framework is the first of Four Pillars of International Subsidiary Governance. Not only will each regulatory regime be different in each country, each country will vary in its level of development. Regulators in the United States and the UK may have a similar sense of rigor in their intentions, but their laws and processes remain markedly different. Other nations may not even have the same degree of regulatory standards. The World Bank recognizes this situation in their annual ranking of countries, the most recent of which is entitled: "Doing Business 2013 - Doing Business in a More Transparent

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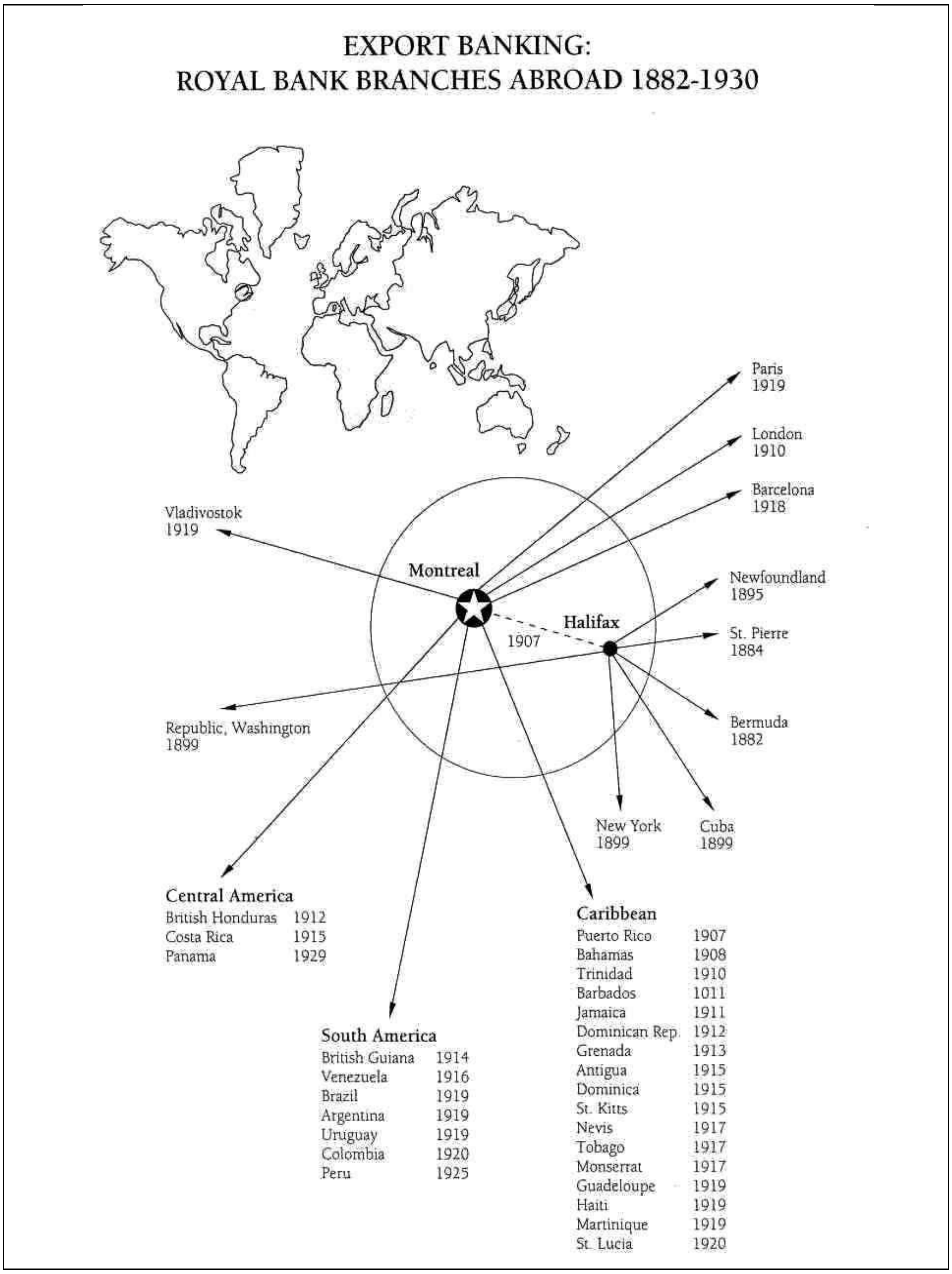
[195] Bank of Nova Scotia – "The Scotiabank Story" – See: http://www.scotiabank.com/ca/en/0,,476,00.html
[196] McDowall, D. – "Quick to the Frontier – Royal Bank of Canada", McClelland & Stewart; (1993) p 195
[197] Carmichael, T, "Passport to the Heart – Reflections on Canada Caribbean Relations", Ian Randal Publishers 2001, pp 3-6
[198] Ibid, Bank of Nova Scotia

World"[199] which compares countries according to their level of regulation, governance, and the maturity of their legal systems and business practices.

Figure 4: RBC's International Expansion 1882 – 1930*



(Source: McDowell - "Quick to the Frontier – Royal Bank of Canada")

[199] The World Bank - "Doing Business 2012" - See: http://doingbusiness.org/reports/global-reports/doing-business-2012

These publications provide business leaders, government officials and regulators with relative insight into the disparate environments that await companies who are interested in international expansion. Although it is difficult to explore here the full context of the corporate governance environments that exist globally for Canadian banks, they can be divided into two primary groups: developing economies and developed economies.

Developing Countries

For developing countries, I propose that the World Bank's 2012 report provides valuable insight into the economic and social circumstance that international banks and companies face in doing business in lesser developed countries and emerging markets. Three of Canada's banks have a material presence in emerging markets. Scotia, RBC and CIBC (under the brand name "First Caribbean Bank") all operate significant retail banking networks throughout the Caribbean. Additionally, Scotia is quite unique in that its international strategy includes extensive investment in South America and Central America as well as other emerging markets including Asia not only as a diversification strategy but also as an investment strategy that will benefit shareholders longer term.

From a governance perspective, as banks move into lesser developed countries, home boards need to ensure that they have the appropriate risk management, audit and other hard controls in place. They also need to have effective "Know Your Clients Rules", as outlined by the Canadian Bankers Association[200]. These cautionary practices will help these international banks prepare for serious international banking issues such as anti-money-laundering. A foreign regulatory environment that is less rigid in its local banking practices simply presents new risks to Canadian banks. It is thus crucial for main bank boards to ensure that their international subsidiaries and branches are operating at Canadian standards.

Developed Countries

Investigating corporate governance practices in other developed economies reveals environments that are markedly closer to Canada's own regulatory conditions. It should also be noted that Canada's international banks (with the

[200] Canadian Bankers Association – "Opening a Bank Account" – See: http://www.cba.ca/en/consumer-information/40-banking-basics/83-opening-a-bank-account

exception of Scotiabank) tend to concentrate their foreign operations in English-speaking countries. These markets are lucrative and easier for Canadian banks to integrate with. We see for instance in appendix B that all Canadian banks have capital markets operations in the United States (New York) and the UK (London). These are substantial operations. In addition, TD Bank and Bank of Montreal have significant retail banking operations in the United States. As we look at corporate governance issues for Canadian banks in foreign developed countries, the United States and the United Kingdom in particular are of crucial importance because of the concentration of Canadian subsidiaries.

The rules and regulations of corporate governance in the United States for banking is complex. For instance, both the federal and state governments there can issue banking licenses. At the federal level, a bank may have any of the following as its chief regulator: the Federal Deposit Insurance Corporation, the Federal Reserve Board, or the Controller of the Currency. Because of this diversity, the Big 5 banks that all do business in multiple locations in the United States face a complex web of regulators. Each bank and branch in the United States is subject to regulation and examination by the authority that issued its license. Two other sets of laws that also affect the banks' subsidiaries and branches are the International Banking Act and the Bank Holding Company Act, both which specify authorized activities within the United States. These Acts also specify capital ratios, the requirement to meet certain examination (audit) ratings, and requirements on effective policies for controlling money laundering and terrorist financing. Because of the overlap and diversity of regulatory agencies in the United States, the particular location of the subsidiary may mean that it is regulated by more than one federal and state agency.

In addition to banking regulators, Canadian banking subsidiaries in the United States need to comply with additional legislation and regulators. These include the Sarbanes-Oxley Act, the new Dodd-Frank Act, the Securities and Exchange Commission, and the Financial Industry Regulatory Authority (FINRA). Further still, nongovernment agencies such as the New York Stock Exchange, the Municipal Securities Rulemaking Board, the U.S. Department of the Treasury, the Commodities Future Trading Commission and other exchanges that may be required for their broker-dealer business lines, all have requirements that must be conformed to. So regardless of the actual quantity of jurisdictions that a subsidiary operating in the United States will fall under, the crucial point is that Canadian banks have to be well-informed of their compliance needs well in advance of expanding into the United States.

As discussed, the United Kingdom is another market where Canadian banks have expanded to significantly for capital markets purposes. Unlike the United States, however, the UK is a less fractured framework. The Financial Services Authority (FSA) is the sole regulator of banks there and it continues to evolve its corporate governance practices and regulations with the introduction of the Financial Policy Committee[201] that is expected later this year.

Pillar 2 of Subsidiary Governance: Subsidiary Boards

The second pillar of corporate governance for international bank subsidiaries is the local subsidiary board that is charged with responsibility for oversight of the subsidiary. Canadian banks tend to have their majority of international exposure in developed markets. The exception to the statement is the Bank of Nova Scotia, as explained in the previous section.

Developed markets, like the UK and the United States, have governance regulations that are comprehensive and aligned to the goals of those in Canada and other Western countries. However, these regulators are very strict on how they expect foreign banks to structure themselves and behave. For example, bank subsidiaries in the United States are required to have a board comprised mostly of independent directors, implying that external (nonexecutive) directors have controlling authority over the subsidiary that supersedes the parent bank (which is often 100% owner). And while the subsidiary may be a wholly owned subsidiary of a Canadian bank, the directors still owe a duty of safety and soundness to the local bank and to the local regulators.

Mature markets like the UK and the United States carry a heavier burden of corporate governance regulation and are also the most prone to changes to their regulatory environments. It is up to the local subsidiaries of Canadian banks to invest the time and money to remain current and in compliance with these

[201] HM Treasury: “A new approach to financial regulation: Judgement, Focus and Stability”, p. 4

modifications. Recognizing how each country involved, some developing a legal framework based on civil law, others using the common law, and noting their preference for rules-based versus principles-based codes, it is impossible for banks to create a single global governance model that would satisfy every local need for banking governance. That said, organizations like the G20, the Basel Committee on Banking Supervision and the Financial Stability Board are each attempting to harmonize banking behaviours and standards around the world.

On this theme, one key recommendation from the 2009 Walker Review referenced the Combined Code and recommended that the majority of directors (excluding the chair) be independent (nonexecutive) to the bank. This includes international bank subsidiaries that operate in the United Kingdom. In another publication, the International Finance Corporation of the World Bank directly targeted international banks when it stipulated that "parent banks need to be aware of subsidiary bank governance practices and ensure that subsidiary banks adhere to appropriate governance practices from both parent and subsidiary jurisdictions." [202] This implies a double-duty of compliance to both the host as well and the home regulators. Of course, the added layer of governance and compliance increases the complexity of doing bank-related business in international markets and can pose problems for developed markets that expect foreign banks to follow the same corporate governance and board regulations as their home nations.

These issues will affect the composition of the subsidiary—and possibly the loyalties of the subsidiary board because the subsidiary board could in theory decide to move the subsidiary in a manner that maximizes its own benefit but at the cost of the parent company and shareholder. Consider for instance a subsidiary that decides to cut prices in order to win a contract it is competing against with another bank affiliate. While it may be locally effective to act this way and beat out the immediate competition, to achieve the status of a *glocal* firm requires more integrated interaction between the parent and the subsidiary board. From the main board's perspective "local (stakeholder) approach" always needs to be in balance with the "global (shareholder) approach"[203] that takes into

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[202] World Bank – IFC – "Corporate Governance of Banks", June 16, 2011 – See: http://www.ifc.org/ifcext/cgf.nsf/Content/CG+Banks+SEE+event
[203] Hilb, ibid, p ix

consideration larger concerns. These themes will be explored in greater detail in both the next section and in Section 3.

Pillar 3 of Subsidiary Governance: Parent Bank Boards

The third pillar concerning the corporate governance of international subsidiaries is the parent company's main board. The parent board has global responsibility for governance of all elements of the business, including all entities located internationally. Of the four pillars for corporate oversight, this aspect is the most critical for ensuring effective governance. As will be shown, the home regulator ultimately looks to the main board for all corporate governance issues and compliance. The particular manner in which Canadian banks achieve this will be explored in further detail in Section 3 (Empirical Section).

Pillar 4 of Subsidiary Governance: Home (Canadian) Regulators

The fourth pillar identified here concerns the nature of the parent bank's home regulator. In the case of Canadian banks, this is OSFI. As shown in Section 2.2.1.2, OSFI clearly underscored the importance they pay to subsidiary governance when they published their first Corporate Governance Guideline in January, 2003. In that publication, an entire section (VII) was dedicated to the "Governance of Subsidiaries and Holding Companies"[204]. While it was still early in the development of corporate governance principles and regulations, OSFI was a forerunner in their instructions to the boards of Canadian banks:

> **Parent boards must be aware of all material risks and other issues that may ultimately affect the organization. As some of these risks may originate in subsidiaries, it is necessary that the parent board be able to exercise adequate oversight over the activities of the subsidiary.**[205]

As discussed previously, OSFI's mandate is to review banks on a consolidated basis. Its supervisory powers also extend to include any nonbanking corporate body of a bank that has been deemed to carry a significant risk profile as well as foreign operations, subsidiaries and affiliated companies of the bank. The Bank Act also requires that banks provide OSFI with access to records of controlled

[204] OSFI – "Corporate Governance Guidelines – 2003" – Section VII, pp 14-15
[205] Ibid – p 14

domestic and foreign subsidiaries and authorizes the Superintendent to enter into agreements with foreign regulators in that regard. In addition to meeting with the board, board committees, and management, OSFI conducts periodic reviews (audits) on international subsidiaries and follows a risk-based approach. In this way, the Canadian regulator has responsibility and complete access to any international subsidiaries of Canadian banks. It has this authority to ensure that effective corporate governance is in place within any subsidiaries that it deems to be material or carrying a significant risk profile, even though they are located outside of Canada. OSFI does travel to audit these entities.

These are the four Pillars of Corporate Governance for International Subsidiaries. Let us now focus our attention to Governance and board processes inside international subsidiaries

2.2.3 Subsidiary Governance of International Canadian Banks

Due to the nature of these four pillars of corporate governance relative to international subsidiaries, it would be useful to examine the various options that exist for subsidiary boards as it relates to the main board. In this capacity, I will draw on two of Hilb's concepts. First, I will examine the "degree of internationalization"[206] present within a given subsidiary to determine the extent of their international networks and their capabilities and the impact it has on how Canadian banks operating their international subsidiaries and structure their international subsidiary boards. Secondly, is the extent of holding-company control with the subsidiary's "degree of freedom"[207] – this reveals options available to Canadian banks in directly managing or allowing the local subsidiary to manage itself and similarly the effect that these strategies play on the involvement of the parent organization as well as the make-up of the international subsidiary board.

Degree of Internationalization

Molloy and Delaney in Figure 2 provided the evolution and development lifecycle that subsidiaries go through. In a similar fashion, Hilb in Figure 5

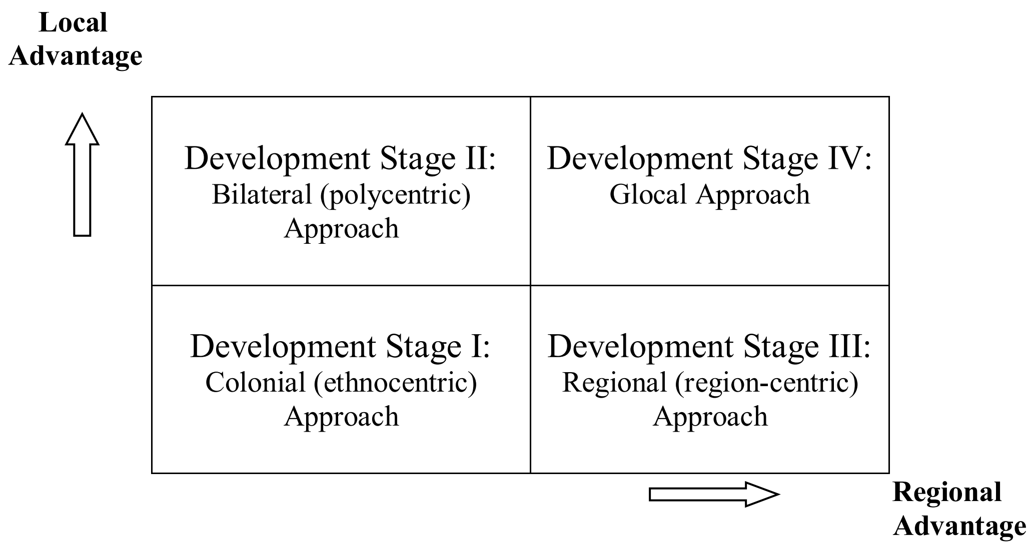
[206] Hilb, ibid, pp 57-62
[207] Ibid, p.90

(Degree of Internationalization) demonstrates the options available to subsidiaries as they go through their international development lifecycle and in Figure 6 (Subsidiary Degree of Freedom) the options available to the parent and the subsidiary in how the subsidiaries are operated and how the subsidiary board is structured in support of various strategies.

Development Stage I:
Characteristics of Stage I. the “Colonial Approach” include having expatriate management in both the subsidiary’s CEO and the Chair roles, and having human resource policies of the home office applied in all domestic and foreign operations. This Stage is often used at the beginning of a subsidiary lifecycle process. The disadvantages of this stage include high costs for expatriates and the lack of good local middle managers due to the preference for expatriate managers and directors.

Development Stage II:
Characteristics of Stage II, the “Bilateral Approach” include a degree of local autonomy possessed by the subsidiary in developing policy for itself. Also the majority of subsidiary board members and employees are recruited locally. This Stage presents a low cost alternative. The disadvantages of this Stage include having limited developmental opportunities for subsidiary directors and employees.

Figure 5: Degree of Internationalization



(Source: Hilb, M. 2006)

Development Stage III:
Characteristics of Stage III, the "Regional Approach", include seeing the emergence of a unified regional model of employee recruitment, compensation and development. This stage is often used in more mature regional structures of multinational organizations. The disadvantages of Stage III include the inability to fully develop local board directors and employees to maximize their global capability to the best advantage of the parent organization.

Development Stage IV:
Characteristics of Stage IV, the "Glocal Approach" include the ability to develop worldwide normative guidelines with consideration for strategic regional conditions and peculiarities. As companies become more *glocal* they begin to balance the global needs of the shareholders with the local needs of the stakeholders. The movement toward an increased degree of independence for Board directors and employees will also grow.

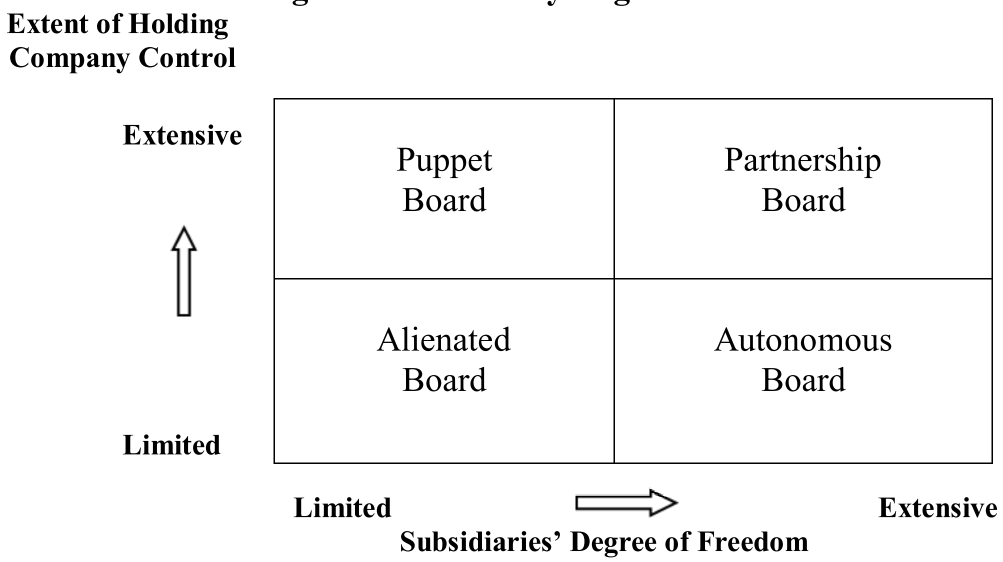
Distinguishing Canada's banks relative to their "degree of Internationalization" will become increasingly important as this analysis continues. Are all of Canada's international banks in identical situations? Do their international subsidiary boards vary by degree of materiality of risk, as presented by OSFI? I will explore this in my Empirical Analysis - Section 3.

"Puppet Boards"

Turning our attention to the powers and authorities of the board we examine Hilb's work on subsidiaries' degree of freedom (see figure 6). There is a serious concern in corporate governance literature that subsidiary boards, both domestic and international, may not be performing their full governance roles. That is to say, some subsidiaries may simply be acting as figureheads and only serving the parent company in a perfunctory way. Hilb calls these puppet boards, and his work on the degree of freedom possessed by a subsidiary board is useful for an analysis on international banking subsidiaries in this way.

Figure 6 provides a framework of control that a parent company can have relative to the degree of freedom authorized in its subsidiary. As the success of corporate governance in Canada's international banking subsidiaries is explored, this will be an interesting test of governance effectiveness. There are 4 primary options for aligning a subsidiary based on the extent of the parent company intended control of the subsidiary and the degree of freedom that the subsidiary either requires to operate or is allowed to have by the parent company. When subsidiary boards have limited freedom and there is limited control coming from the parent organization, the subsidiary is Alienated – it is drifting without power and without direction. When the subsidiary board has limited freedom with extensive control from the parent organization, the subsidiary board is simply rubber stamping what the parent organization demands of them – they are a Puppet Board[208]. On the opposite side of the spectrum, when the subsidiary board has extensive freedom with limited control coming from the parent organization, the subsidiary board is virtually independent. That said, Autonomous boards may not be acting in the best interest of the international organization because they are without global insight. The fourth possibility is when a subsidiary board had extensive degrees of freedom and extensive input from the parent organization; they are working in Partnership. According to Hilb, this is the most effective model for *glocal* organizations with international subsidiaries.

Figure 6: Subsidiary Degree of Freedom[209]



(Source: Hilb, M. 2006)

[208] Puppet Boards are discussed in greater detail in my Empirical Analysis (Section 3).
[209] ibid

2.3 GLOCAL Management of Subsidiaries of International Banks:

Now that I have examined the regulatory, corporate governance and subsidiary environments of Canadian banks, attention can now be turned to glocal management initiatives for the subsidiaries of international banks. First, I will examine Hilb's *glocal* framework for international companies. Then I will introduce the research of Geert Hofstede in order to better understand the implications of managing across cultures. This will naturally then lead to reviewing the parent and subsidiary boards as we explore glocal direction and control of subsidiaries of international banks, By applying HILB's "Reversed KISS" framework. I will then analyze how Canadian banks can be successful in creating "good corporate governance" in their international subsidiaries.

Hilb's framework for new corporate governance recognizes that business in the twenty-first century is becoming more multinational. To be successful internationally, business leaders need to become aware of a broader group of global stakeholders and make adjustments to their corporate behaviours and practices—practices that made the company successful in their home market.

Reviewing financial collapses from the past revealed that some element of corporate governance was missing. In one famous case, Nick Leeson drove Baring Brothers, a hugely successful company, into bankruptcy. A more recent failing in the UK was the crisis in Rupert Murdoch's media empire, which resulted in the closure of his London-based newspaper, *News of the World*. This breach of ethics within Murdoch's UK subsidiary may unfortunately become his most lasting legacy, after a lifetime of accomplishment.

It is obviously important for business to be successful in their international (local) markets. But there is also a distinct need for global standards, which relate to the business strategies and practices of the parent organization, to be put in place. This is the territory of corporate governance and balancing the subsidiary's local realities with the parent company's global needs is critical to its international success. Hilb's proposal for *glocal* companies and boards aims to bring both of these needs into balance. As a result, I will be exploring this model in further detail and will use it as a framework for examining Canada's success in achieving good corporate governance in their international subsidiaries.

With an international subsidiary structure, the "shareholder" is the parent organization, and for my research, a heavily regulated Canadian bank. International subsidiaries control and interact with numerous local "stakeholders". In this subsidiary structure, stakeholders include: local employees; customers of the subsidiary; and the local regulator among others. However the stakeholder group for the international subsidiary also includes the parent organization and the stakeholders of the parent, including the home regulator.

2.3.1 Global "Shareholder" Orientation:

A *glocal*[210] company is a transnational firm that simultaneously demonstrates an orientation towards shareholders as well as stakeholders. The board of directors in the parent company has responsibility for oversight of management and ultimately for ensuring good corporate governance across the entire firm, including international subsidiaries. To meet the needs of a global business orientation, the board, through management, needs to ensure that there are standards or policies in place that unify the company as a single organization. These become enterprise-wide standards, policies, and goals, as TD Bank[211] and RBC[212] like to call them. Enterprise-wide standards are seen as non-negotiable items that must be active within every office, including international subsidiaries. In the world of McDonald's fast food, the iconic "Big Mac"[213] would be an enterprise-wide standard that needs to be universally consistent and available for the company's brand to be effective internationally. In a banking environment, enterprise-wide standards would include items such as bank values, mission statements, global human resource standards like the requirement to treat fellow employees with respect, and codes of conduct. These standards collectively aim to address questions of identity such as: what kind of company are we? What is our tolerance for risk? What are our competitive advantages? And, what is our long-term strategy and goals?

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[210] Hilb, ibid, p 22
[211] TD Bank - 2011 Annual report, p 9
[212] RBC Annual Report 2011- p 6
[213] McDonald's Annual Report 2010, p 2, see: http://www.aboutmcdonalds.com/content/dam/AboutMcDonalds/Investors/C-%5Cfakepath%5Cinvestors-2010-annual-report.pdf

Enterprise-wide standards serve as a common set of parameters that guide all business leaders and employees in every location of the company. This necessarily includes international subsidiaries. By establishing enterprise-wide standards, the parent company is communicating what is critical for shareholder orientation across all stakeholder groups including business leaders, employees, subsidiaries and subsidiary board directors.

2.3.2 Local Stakeholder Orientation:

It is intuitively known that customs and practices vary according to geographic and social location.151 The international subsidiaries of Canadian banks subsequently operate in environments that are different from the environment of the Canadian parent bank. This means that each country's culture and industry norms and practices will be unique to that country. To be successful in the local market the parent company therefore needs to recognize these differences and meet the needs of its local stakeholders.

Each subsidiary's stakeholders include the local regulator, the local board directors, and the local management, employees, and customers of the subsidiary. The unique needs of management and employees might include the working language of the office (e.g. Spanish or Portuguese in Latin America), the ability to have a fulfilling career in their home location, local compensation programs, and other human resource norms. Relative to clients, local needs might include the language of service and reporting, using local people as service providers, and unique product preferences or biases. Continuing with the McDonald's example mentioned above, McDonald's 2010 annual report made reference not only to enterprise-wide initiatives like the "Big Mac" but also to the development of local products like "McWraps in Europe, "Angus Burgers" in Australia, or "McCafé specialty coffees" in the United States"[214].

Other important stakeholders for international bank subsidiaries include the local regulator and the subsidiary directors. The needs of the local regulator will include meeting their unique regulatory and reporting requirements and most if not all foreign countries will expect the parent company to respect their authority

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[214] ibid

and practices. Similarly, the locally-based board will have several unique needs. These could include possessing real authority from the parent company, having clear information from the parent concerning the expectations of the main board relative to subsidiary operation, feedback from the parent on material items affecting the parent that might be key to the success of the subsidiary board and its directors, and all of the rights and privileges that board directors carry in the host country.

By following a global shareholder orientation in conjunction with a local stakeholder orientation, multinational companies can effectively achieve the needs of the shareholder concurrently with the requirements of stakeholders in each local market. *Glocal* firms focus on the needs of the local clients and employees; they also include having main boards and subsidiary boards that are operating with a *"glocal"* mindset. As we will see in Section 2.3.3, "linking pins" between the parent company and the subsidiary boards play a critical role in this balancing act. To understand the cultural challenges that exist for international banks, and how these might affect good corporate governance, I now turn to Hofstede's and House's research on cross-cultural management.

2.3.3 Cross-cultural Management and Controls Framework:

Even successful companies can falter as they face the challenges of expansion outside their home market. Sensitivity toward cultural differences and practices often plays a pivotal role in the success of international companies. Understanding and addressing cross-cultural differences has been of increasing interest to academics and business as globalization has grown particularly over the last three decades. Why did McDonalds, for instance, which is one of the world's most successful fast food franchises, withdraw from Bolivia and Barbados after 5 years and 6 months respectively[215]? Alternatively, what was it about the multi-cultural environment that prompted Disney to introduce alcohol (wine) and salads in their restaurants in Paris when "Coke and onion rings" are so popular in the United States? At the heart of both these examples, the general question is the same: What role did culture play?

[215] Wikipedia – McDonald's Former Locations - http://en.wikipedia.org/wiki/List_of_countries_with_McDonald's_franchises#Former_locations

In the 1970's, Dutch researcher and social psychologist Geert Hofstede[216] surveyed individuals in 40 countries. At the end of his research he aggregated the responses into societal groups and differentiated respondents by country. As a variable, Hofstede defined culture as "the collective programming of the mind that distinguishes one group or category of people from another"[217]. Hofstede published a follow-up paper in 1980 called "Culture's Consequences: International differences in Work-Related Values"[218].

This article is the first in what is now considered Hoefstede's influential work on national cultures. In it he identified four dimensions of culture:

- Power / Distance
- Uncertainty Avoidance
- Collectivism / Individualism
- Feminine / Masculine

In distinguishing groups of people or cultures according to these four dimensions, Hofstede created a framework to understand the cultural differences between nations and regions of the world. Robert J. House[219] later led a group that performed an extensive 10-year study to examine 62 countries using Hofstede's four dimensions. Released in 1994 as the GLOBE Research Study, House et al expanded on Hofstede's model to nine cultural dimensions which they labeled the "culture construct model"[220]. The nine dimensions examined by House et al, were:

- Power / Distance
- Uncertainty Avoidance
- Human Orientation
- Collectivism I
- Collectivism II
- Assertiveness

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[216] Hofstede –"Culture's Consequence. Comparing Values, Behaviours, Institutions and Organizations across Nations" 2001, pg. 440
[217] Ibid – See: http://www.geerthofstede.nl/culture.aspx
[218] Ibid - "Culture's Consequences: International differences in Work-Related Values" – (1980), Beverly Hills
[219] House et al, "Culture, Leadership and Organizations – The GLOBE Study of 62 Societies", pg 5
[220] Ibid , pp. 29-32

- Gender Egalitarianism
- Future Orientation
- Performance Orientation

In their research on the GLOBE Study, House et al. noted that:

> **"The increasing connection among countries and the globalization of corporations does not mean that cultural differences are disappearing or diminishing. On the contrary as economic borders come down, cultural barriers could go up thus presenting new challenges and opportunities in business. When cultures come into contact they may converge on some aspects, but their idiosyncrasies will likely amplify".**

They then offered the following conclusion:

> **"… to succeed in global business, managers need the flexibility to respond positively and effectively to practices and values that may be drastically different from what they are accustomed to. This requires the ability to be open to others ideas and opinions. Being global is not just about where you do *business but how you do it".*[221]**

Hofstede's original work and the subsequent research by House et al. on the Cultural Construct model provided one of the most important advancements in understanding and examining the cultures of other countries and other groups like international corporations. It allows researchers, academics, and practitioners to examine different countries to obtain insight to areas that might be sensitive or present gaps in cultural approaches. For example, international corporations can apply the Cultural Construct to their own culture and compare it to the home market or targeted international markets to obtain insight to differences and preferences. It may not be perfect but this framework provides an analytical tool for recognizing the importance of understanding cultural differences.

For example in earlier[222] research conducted at St. Gallen University I applied the Culture Construct model to Canada's largest bank, RBC. By applying House's framework to RBC and comparing their rating to Hilb's ideal for a

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[221] Ibid, p 5
[222] Sears, T. – HRM Policies & Practices at RBC Financial Group", June 2007, St Gallen University, p 4

“glocal” company I conclude that RBC’s ratings are generally higher than the GLOBE study findings for “cultural, leadership and societal effectiveness”. These ratings are also consistent with RBC’s efforts at being “hard” on performance and “soft” on people[223].

I concluded that RBC operates with the following Culture Construct ratings:

Table 11: RBC’s Culture Construct

Culture Construct Dimension	RBC’s Ratings	Hilb’s “Ideal”
Power-Distance	Low	Low
Uncertainty Avoidance	Average	Low
Human Orientation	High	High
Collectivism I	Average	Average
Collectivism II	High	Average
Assertiveness	Average-Low	Low
Gender Egalitarianism	Average	Average
Future Orientation	High	High
Performance Orientation	High	High

(Source: Own Conclusion based on Hilb[224] and House)

Hofstede’s and House’s conclusions provide business leaders with a concise framework to understand differences in culture, regardless of group size, and are thus useful for examining both nations and organizations. As such, these frameworks need to be taken into consideration when opening and operating a subsidiary in a foreign jurisdiction.

Bi-cultural Executives & Linking-Pin Leaders

As Hofstede advanced his work, he proposed that cross-cultural success requires executives to be “bicultural”:

> **“It is my firm impression that the failure rate of non-home-culture executives in multinational business organizations is much higher than that of home-culture executives, precisely because the former frequently do not succeed in becoming sufficiently bicultural”.[225]**

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[223] Hilb, “Glocal Management of Human Resources” – page 11
[224] Hilb – “Glocal Management of Human Resources” – page 11
[225] Hofstede, ibid, p. 440

In examining success across cultures, Hofstede identified that certain employees are in "linking pin" roles. These individuals serve as important ambassadors in the international subsidiary capable of "translating" information flows between the parent and the subsidiary that adjusts for cultural differences between the locations. They also need to be bicultural:

> **"Ordinary members of foreign national subsidiaries do not have to be bicultural; only those in "linking pin" roles between national subsidiaries and the international superstructure need to be biculturality … because these linking agents need a double trust relationship, both with their home-culture superiors and colleagues and with their host-culture subordinates".[226]**

The work of Hofstede and House provides a clear framework to understand the challenges that Canadian international banks face when managing a complex web of international subsidiaries across multiple countries and cultures. We will return to these themes when I investigate management solutions and techniques that are in place to ensure and maintain good corporate governance.

2.4 GLOCAL Direction and Control of Subsidiaries of International Banks

Now that we have a reviewed *"glocal Management"* of international subsidiaries, let us turn our attention to how Boards can ensure "*glocal Direction and Control"* of these international subsidiaries of Canada's banks.

Hilb's reference to glocal organizations and boards is a component of the larger integrated approach to corporate governance that he calls new corporate governance. New corporate governance is based on his own "Reversed KISS" principles, a model that proposes new behaviours and processes for international companies. To ensure that their quest for good corporate governance is successful on an international scale, companies must simultaneously follow a shareholder and stakeholder orientation. This is precisely what the "Reversed KISS" principles are meant to achieve. In part III, I employ this framework to analyze Canada's international banks and examine whether they have achieved

[226] ibid

good corporate governance at home and abroad. Before that, it is necessary to first understand Hilb's new corporate governance approach and the specific metrics contained in the Reversed KISS principles: Situational, Strategic, Integrated and Controlled.

"New Corporate Governance" Framework

In the 1990s, when both Maxwell and Barings were in the midst of collapse, and in the decade that followed, it was becoming increasingly evident that governance efforts were simply not working. While regulators responded with a flurry of new rules and laws, one thing remained constant: it was and continues to be the responsibility of the board of directors to ensure that governance processes are operating effectively for the long-term interest of the corporation. Academics and practitioners alike debated new models for governance but this fundamental goal remained. At that time there were two dominant structures for boards: the Anglo-American model that operated predominantly in the UK and United States, which focused on building *share*holder value and was thus market-oriented. The second is the relationship-based model that operated in Europe, Asia and other parts of the world and focused on a broader audience of *stake*holders.

Although the shareholder model and the stakeholder model both have merits the evidence of corporate governance failures discussed earlier indicates that both models also have flaws. Hilb's new corporate governance165 model takes the best of both models and says that the boards of international companies need to be both shareholder-oriented *and* relationship-based; this is effectively saying that companies need to be both globally and locally oriented. To achieve this, Hilb says companies need to:

1. Understand the environment that their organization operates in and ensure that the board and the company are structured for that particular environment
2. Ensure that the company has an effective strategy and that the board and management focus their decisions, processes and actions to achieve that strategy
3. By understanding the environment and the strategy, ensure that all stakeholders – including the board, management, employees and others – are

in alignment with the strategy and working together in an integrated manner and to mutual benefit

4. Through well-developed and effective control mechanisms, monitor all critical aspects of the organization to ensure they are performing satisfactorily and make adjustments as needed to improve and evolve the organization.

Combining the best of the shareholder model and the relationship model, Hilb's "Reversed KISS" principles theoretically give boards a new framework to achieve the combined interests of stakeholders and shareholders. To summarize the points listed above, the four principles for new corporate governance are: Keep It Situational (S), Keep It Strategic (S), Keep It Integrated (I), and Keep It Controlled (K). I will examine each of these principles in more detail, with particular attention to their application for subsidiaries of Canadian banks and will demonstrate the practical benefits to Hilb's model.

2.4.1 Keep it Situational:

Based on constructs developed for institutional and situational theory by Aoki and Fiedler[227] this first principle advises that companies adapt their corporate governance practices to suit the local situational context that they operate within. This principle requires that boards address the external context and cultural aspects that the business operates in, as well as the internal context of the parent corporation.

For the purposes of banking in Canada and internationally, the situational context of an organization's operation is of particular importance. Banking is a highly regulated industry, as demonstrated. In addition, since money flows globally without consideration for political boundaries, a necessary component of the external context is internationalization. The international context also introduces cultural differences that may include language, product specifics, regulatory differences and practices that are foreign to the home environment. Boards subsequently need to understand these situational differences and accept them as realities of business. They must be incorporated where appropriate for business

[227] Hilb, ibid, pg. 6

to be successful and to enact effective governance practices for both the home market and international subsidiary.

It is important to stress that the external context also includes the home market. In Canada, the five biggest banks are not only the nation's largest financial institutions; they are also some of Canada's largest companies. When TD Bank temporarily surpassed RBC to become Canada's largest corporation in November, 2011, it made headlines in Canada167. At that time, these banks collectively employed 260,000 employees (2% of Canadian households), paid $18 billion each year in salaries, helped 1.2 million small and medium sized companies with start-up and growth financing, paid $8.3 billion in taxes to the federal government, paid $10 billion in dividends to investors, and contributed $55 billion to Canada's GDP (3%)168. How these banks fare and how they behave affects not only the economy but also the widest range of stakeholders, including employees, government, small business borrowers, investors and other beneficiaries of Canada's tax system (such as schools and hospitals). So while the domestic external context is where these banks have historically excelled, this context is of paramount importance not only to the banks themselves but also to the nation as a whole.

The internal business context also brings forward many challenges for the boards of international Canadian banks. As companies become more globally focused, they naturally question whether they need to develop new organizational structures and align the processes and people within the bank with the international regions their business will encounter. Do they have the right people, the right skills, and the right ownership and board structures to be effective in these international markets? Can the subsidiaries find effective local directors for their subsidiary boards who will remain in alignment with the Canadian parent? An additional consideration for these multinational bank boards is the mandate they give their subsidiary boards and subsidiary directors. Their decision concerning this factor is critical and must take into consideration a combination of both internal and external business realities. In fact, the subsidiary board's mandate and makeup must also take an consent into consideration that subsidiary's particular stage of development (Figure 1).

In the past it was common for directors of subsidiaries to play a token role. "Puppet Boards" (discussed in Section 2.2.3) performed perfunctory roles, fulfilling only the statutory duties required by a host country's legal system. In the late 1980s, however, Kriger and Rich (1987)[228] observed a trend towards increased reliance on subsidiary boards that was reconfirmed by Kriger again in 1988[229]. Kriger's studies included an examination of international subsidiaries of Japanese firms that had need to address local responsiveness, particularly as they crossed cultures into North America and Europe. Canadian data, Gillies and Dickinson (1999) disagreed with Kriger's findings and suggested that "despite the benefits that 'strong independent subsidiaries' can bring to MNEs, subsidiary boards are not playing an increasing role in the operations of MNEs."172 They went on to argue that the role of subsidiary boards was in fact rapidly declining. Kiel,173 proposed that subsidiary boards may have to follow both the internal context of the MNE and take into consideration the external context as it pertains to local responsiveness. Kiel's views will be explored in more detail below as they relate to Hilb's second principle.

These are some of the Situational issues of internal and external context that I will be examining as I review the Big 5 Canadian international banks and their international subsidiaries.

2.4.2 Keep it Strategic:

Based on constructs developed for stewardship theory[230], the second principle, Keep it Strategic, advises companies to have an effective strategy and to keep that strategy at the centre of the board's work and deliberations. This principle is central in aligning the board with the company's activities, processes, and direction. This principle is further complimented by the fourth principle, Control.

International expansion for Canada's Big 5 banks has been a growing component of their business strategies for over a century. Following the Keep it Strategic principle entails that these bank boards ensure their international presence

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[228] Kriger, M., Rich, P. – Strategic Governance: Why and How MNC's are Using Boards of Directors in Foreign Subsidiaries" – Columbia Journal of World Business – Winter 1987 – pp. 39-46
[229] Kriger, M. – "The Increasing Role of Subsidiary Boards in MNC's: An Empirical Study" – Strategic Management Journal, Vol. 9, (1988), pp. 347-360
[230] Hilb, ibid

continues to be of strategic importance for the company and that it remains aligned with the overall bank strategy. Board directors need to have skills that are consistent with both the organization's international and domestic strategies, so subsidiary boards, and other international stakeholders need to be networked with the main board. To make this work, a culture of trust is needed, both at the parent and subsidiary board levels, so that the international component of the bank's strategies can be effectively implemented.

Relative to the Keep It Strategic principle, I am particularly interested to see how interviewees view their international strategy changing in the future. However a forward-looking view concerning the importance of their bank's international presence will be important in understanding what they will need to consider in the future in support of their strategies to maintain, grow or shrink their international networks. These themes will be explored during interviews to obtain insight into any required change management processes and the impact these changes may have on the boards of their international subsidiaries.

As previously discussed (Section 1.1.2), researchers such as Kriger, Gillies and Dickinson, Kiel et al., and Du et al. have all studied the roles that subsidiary boards play and the conditions that drive these board structures. In their research, Kiel et al. provide us with a very useful framework for governance of international subsidiaries that follows closely with Hilb's view to set a glocal strategy for subsidiary boards to achieve local responsiveness as well as global integration. Below, I outline Kiel et al.'s four strategies for international subsidiary governance for MNEs.

Corporate Governance Options for International Subsidiaries (Kiel) [231]

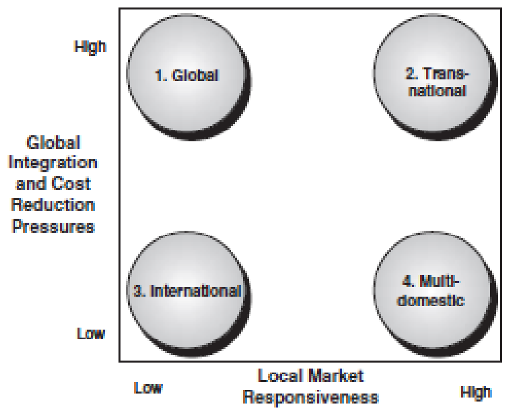
Kiel et al. contend that the role and structure of the subsidiary board should be tied to MNE's strategy for that subsidiary. 176 They further contend that in a multinational network the MNE might use different board models based on the strategy it desires for each subsidiary. Consistent with Hilb's glocal framework for board effectiveness, Kiel et al.'s framework examines what structures and authorities would be most effective for a particular subsidiary board. It achieves

[231] Kiel, G., Hendry, K., Nicholson, G. – "Corporate Governance Options for Local Subsidiaries on Multinational Enterprises" – Corporate Governance – Vol. 14, No. 6, Nov. 2006 – p. 570

this based on the parent corporation's need for local responsiveness as well as the need for global integration and cost reduction.

In his model "Governance Options for International Subsidiary Boards", (See: Figure 7) Kiel presents four strategies for the effective use of subsidiary boards. Each is dependent on the conditions that surround that subsidiary. Kiel also provides a subsidiary board model for each strategy. They are:

Figure 7 – Governance Options for International Subsidiary Boards



(Source: Kiel)

Subsidiary Strategy:	**Subsidiary Board Structure**
1. Global Strategy for Subsidiary Boards	- Direct Control
2. Transnational Strategy for Subsidiary Boards	- Dual Reporting
3. International Strategy for Subsidiary Boards	- Advisory Board
4. Multi-Domestic Strategy for Subsidiary Boards	- Local Board

Global Strategy for Subsidiary Boards

As an example of his Global Strategy for a subsidiary board, Kiel examines the situation of an international subsidiary of an MNE that produces semiconductors. This subsidiary has a low need for local market responsiveness but greatly requires global integration and cost reduction measures. As a semiconductor manufacturer it produces and sells a standard product, so the driving business need for their success is a low manufacturing cost. In this example, the MNE might establish their operations in India, Asia, or Indonesia where labour costs are low. Apart from hiring local labour the needs for these MNE's to achieve "local responsiveness" is also very low.

In this global strategy, the subsidiary can be established in any international location where labour costs are low. Under these conditions the subsidiary board is not focusing on the local market itself. The buyers of semiconductors are international businesses where the semiconductor will be bundled into a computer or other device and sold to consumers by another international business. There is subsequently no interaction with the local public or consumers by the international semiconductor subsidiary.

Kiel proposes the board governance option to support this business strategy is one of direct control from the parent corporation. In this model, the subsidiary board could be comprised entirely of local managers who are easily able to comply with local laws. It would therefore be a legal compliance board with no formal responsibilities and could easily be classified as a "Puppet Board".

The strength of this governance model is that the parent has direct control over the subsidiary relative to its costs, its actions, and its integration into the broader strategy for the MNE. The weakness of this model is that the parent corporation may not understand the local market for key decisions, which could for instance result in staffing issues. There could also be delays in decision making and control of the subsidiary may ultimately be fragmented across several managers.

Transnational Strategy for Subsidiary Boards

Kiel's "Transnational Strategy" is best used when the pressures for both local responsiveness and global integration (cost pressures) are high. These competing demands make this a difficult strategy, combining both decentralized and centralized decision making and requiring the subsidiary and the parent corporation to effectively share authority.

From personal experience I have seen this strategy used by Canadian banks that operate retail operations in foreign jurisdictions. The global need for quality, brand, and low costs are coupled with the need for local products, services, and regulatory needs. This strategy requires the subsidiary board be able to provide a strong local representation. It also requires direct input on local strategies as well as effective representation for the global requirements and oversight required by the parent.

Kiel proposes the board governance option to support this business strategy is one of dual reporting where governance needs to be split between the local board and the parent corporation. In this model, the CEO has a dual reporting line to the local board as well as to parent management. The strengths of this model include improved communication and understanding between parent and subsidiary, as well as ownership of a local board that can assist with local needs. The weakness of this governance model is the possibility of increased costs and duplication of efforts, since costs will be expended at both the parent corporation as well as at the subsidiary for governance oversight and decision making.

International Strategy for Subsidiary Boards

Kiel's "International Strategy" recognizes conditions when the need for local market responsiveness is low as well as the need for global integration (cost reduction). In this strategy, core competencies such as research and development and marketing are centralized while the local subsidiary is involved in value creation in international markets. Examples of this from my experience are international reinsurance operations or international private banking operations that are located in a jurisdiction due to special competencies that exist in that location (e.g. Reinsurance in Bermuda) or due to a favourable geographic location or other advantages such as tax treatment to establish a regional a presence in that country (e.g. Barbados in the Eastern Caribbean), where neither local responsiveness nor low operating costs are the driving strategies. The impact this strategy has on the board is unique because it neither needs to accommodate local market conditions nor follow a low cost strategy.

Kiel proposes the board governance option to support this business strategy is one of an "advisory board" structure where local people are not formally registered as directors, yet are sought for their views and may be given specific local market roles or responsibilities. In this model subsidiary governance is conducted by the parent corporation and its management following a mandate similar to the "direct control" model.

The strength of this model is that the parent company has direct control over the subsidiary. The parent also has the benefit of having local advisors to provide advice and support on local issues. The weakness of this model is that, in attempting to make effective decisions the parent may not adequately understand the local nuances. This model also has duplication of costs, with both a direct control and local advisory board, which may run counter to certain regulatory provisions.

Multi-Domestic Strategy for Subsidiary Boards

The "Multi-Domestic Strategy" most appropriately follows the need for high local market responsiveness combined with low global integration (or costs strategy). A multi-domestic strategy often requires a material amount of strategic decision-making to be conducted at the subsidiary level. The strategy often fits large international companies (such as construction or mining), where local market responsiveness is of paramount importance while the need for global integration is low.

For the Multi-Domestic strategy, Kiel proposes that a "local board" is the best board structure for subsidiary governance. In this model the local subsidiary board has full control and performs all board roles and duties. The strengths of this model are that decision-makers have strong local understanding as well as clarity that they are fully responsible for the subsidiary's actions. From the parent's perspective, this model is the most cost and time-effective option. The weaknesses of this model occur because the parent may be absent from board meetings. A lack of understanding and control necessarily arises at the parent level, which can be especially damaging if it needs to make a strategic change to that subsidiary.

These models will be of increased importance as my analysis on Canadian banks and their international subsidiaries continues to examines the strategies these banks follow when structuring their international subsidiary boards.

2.4.3 Keep it Integrated:

Based on constructs developed in resources dependency theory[232], Hilb's third principle "Keep it Integrated" advises companies to ensure that their board directors have been carefully selected to form an integrated "team". Boards need to be evaluated as a functioning body and individual directors need to be personally evaluated for their contribution and behaviours.

In their research, Du, Deloof and Jorissen (2011)[233] provide empirical evidence that agency theory and resource dependence theory are relevant and complimentary to the analysis of active boards of foreign subsidiaries. Bringing agency theory and resource dependency theory together provides a holistic view of the subsidiary and parent situation and supports Hilb's proposal for glocal board strategies. Since these other theories are intertwined in Du et al.'s research, I will explore their work further in the next section (Keep it Controlled), where agency theory is of critical importance to both the parent and subsidiary boards.

Within the context of international banks and their subsidiaries, I will be looking to see how the main board and the subsidiary boards of directors are aligned and interconnected. I will also be examining how the selection, evaluation, and remuneration processes are integrated into the international components of a board's responsibilities. As outlined above, Hilb proposes that one of the most important activities in ensuring the effective integration of boards is ongoing training and development for all board members. It is critical that constant familiarity exists between boards so that the main board keeps abreast of changes in the regulations and environments that impact their international subsidiaries.

These are the activities and processes I will be seeking as I analyze how integrated these boards are within their own boardrooms, as well as within their own internal networks to ensure the international subsidiaries that they oversee are following good governance practices.

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[232] Hilb, ibid

[233] Du, Y., Deloof, M, Jorrison,A. – « Active Boards of Directors in Foreign Subsidiaries" – Corporate Governance: An International Review, 2011 19(2): pp. 153-168

2.4.4 Keep it Controlled:

Based on constructs developed in agency theory,[234] Hilb's final principle concerns one of the most critical factors for ensuring good corporate governance within a bank. "Keep it Controlled" advises companies to take a holistic view of their governance processes and include not only shareholders but also employees, customers, and the public in their considerations. Focusing on a broader stakeholder group allows the board and its management to have an expanded view on the control elements within their business. This broadened perspective must be in mind when hard controls like audit, risk management, and operational control processes and procedures are created.

Examining international banks and their subsidiaries will require looking into the control activities that are in place giving confidence to boards that management and employees are performing within the boundaries of good corporate governance. An important stakeholder to consider here is the local (host country) regulator. It will be important for parent boards to ensure that both the bank and its international subsidiaries have controls in place to ensure compliance with both sets of regulators. In addition, the home regulator for these banks, OSFI, follows a risk-based methodology for its supervision. Therefore I will be looking to see how the risk committee of the bank board interacts with its international subsidiaries and how these subsidiaries are included in risk-based measures and evaluations, as well as the audit processes. As components of an overall holistic approach to control over their international subsidiaries is the critical use of communication as a control function between the board and its stakeholders. All of these interactions will be of interest for my research.

In pursuing a holistic view of the governance processes, it is difficult to structure a subsidiary board solely on the need for control. Kiel provides an important framework for examining and developing a governance model for international subsidiary boards that simultaneously brings into consideration the need for global integration, cost control, and local market responsiveness. For the multi-domestic strategy, Kiel suggests that local subsidiary boards would be the most effective governance structure.

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[234] Hilb, ibid

Active Boards of Directors in Foreign Subsidiaries

In their research, Du, Deloof and Jorissen (2011)[235] examined 83 foreign subsidiaries in Belgium with parent corporations located in 14 different countries. They sought to obtain insight into the conditions that would drive a parent corporation to consider maintaining an active board for their international subsidiary. In this research, Du et al. defined an active board as "boards that perform tasks beyond fulfilling local legal requirements"[236].

From Kiel's perspective this would include his International, Trans-national and Multi-domestic board strategies, but not the Direct Control strategy.

Du et al.'s research provides empirical support that agency theory and resource dependence theory are complimentary to the analysis of active boards of foreign subsidiaries. On the one hand, this supports Kiel's conclusion that the board has responsibility for control (agency theory). On the other hand, Du et al.'s research also showcased how important the role of the MNE was in the success of an international subsidiary with local market skills and knowledge (resource dependence theory). I will explore these themes further.

Du et al. investigated further the principal-agency theory issue in subsidiary governance and oversight, whereby the headquarters is the principal and subsidiary management is the agent. In this case, subsidiary management may have its own interests and risk preferences which may not align with the best interests of headquarters. To subsequently ensure that subsidiary-level decisions are in alignment with the overall strategy of the parent, agency theory suggests outcome control mechanisms such as incentive compensation. Outcome control is, however, not desirable if the performance outcomes of the subsidiary's management are unclear or difficult to track particularly if information asymmetry is possible. In these cases the use of an active subsidiary board could provide added control for the headquarters.

Du et al. conclude that within resource dependency theory, an MNE is more likely to leverage an active subsidiary board when the international subsidiary

[235] Du, ibid
[236] Hilb, ibid, p. 153

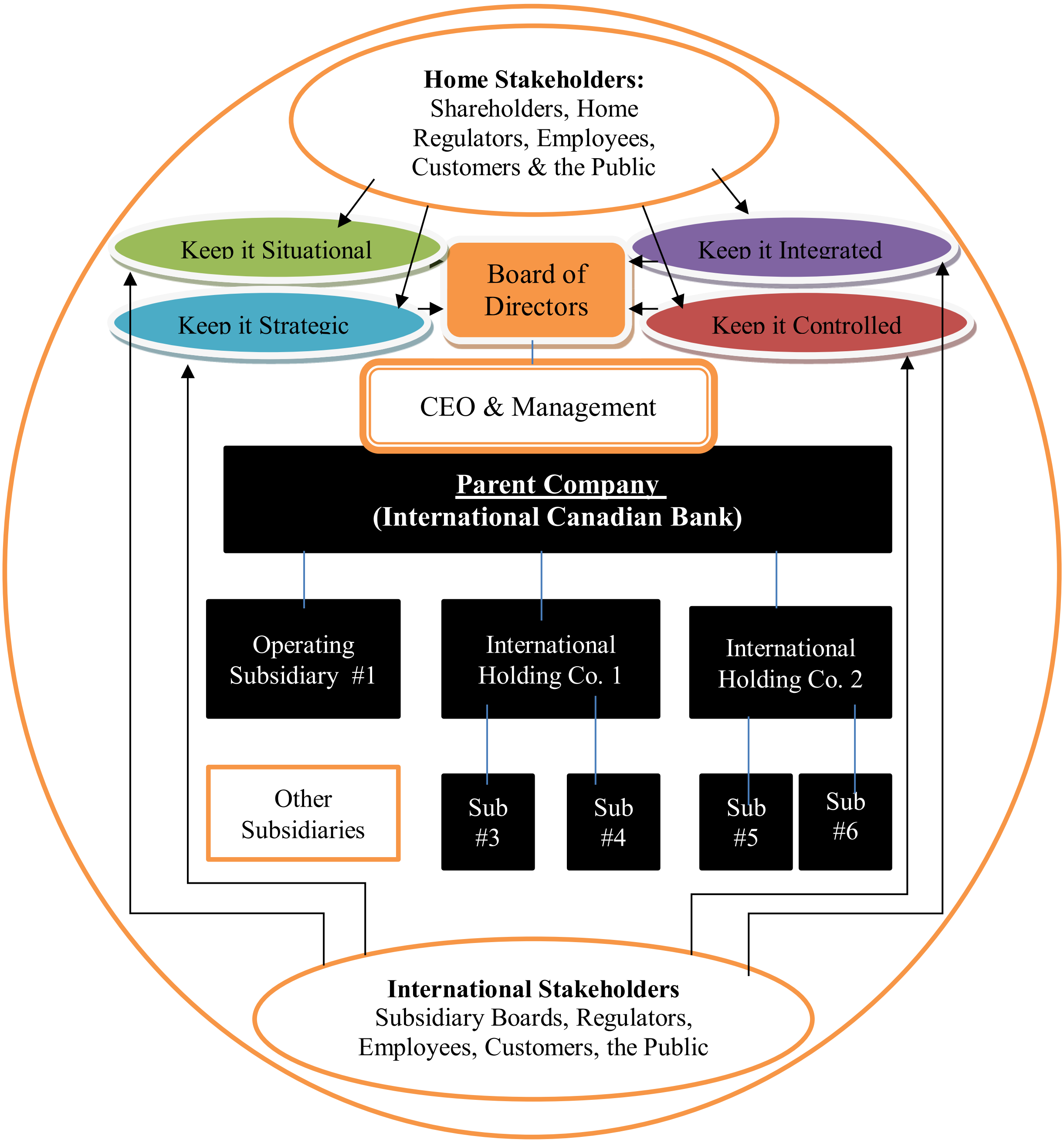
becomes more dependent on the external environment for key resources. In this sense, the authors provide empirical support that agency theory *and* resource dependence theory are both active and complimentary in the decision to utilize an active board for an MNE's international subsidiary. They ultimately conclude that an MNE is more likely to maintain an active subsidiary board under the following conditions:

1. The subsidiary has a worldwide mandate, responsibility for a product line and it performs a broad scope of value-added activities
2. The subsidiary is larger relative to the multinational enterprise (parent)
3. The subsidiary has a higher level of local responsiveness
4. The subsidiary's past performance is poor

The work of both Kiel and Du et al. may shed some light on the different conclusions that Kriger and Gillies and Dickinson (referenced earlier) came to concerning international subsidiaries. For instance, Kriger[237] previously concluded that the role of international subsidiaries was in fact growing but his samples included a considerable presence of Japanese corporations operating subsidiaries in foreign countries. I theorize that that Japanese firms in the 1980s that were establishing operations in North America and Europe would be sensitive to the language and cultural differences in these new geographies and, following Kiel's observations for local responsiveness and Du et al.'s observations for a worldwide mandate, an observer would not be surprised to see these subsidiaries employ a strategy of engaging their local subsidiary directors and encouraging increased roles for the subsidiary board. Gillies and Dickinson's research, which was based on a sampling of Canadian international subsidiary networks, however concluded that the reverse was happening–the role of subsidiary boards was in decline. Relative to the issues faced by Kiel, it seems possible that the Canadian international expansion during that same period was into markets that were culturally similar to the Japanese in moving into Europe and North America. These cultural and linguistic differences suggest that a direct control board structure might be the more effective strategy for these subsidiaries.

[237] Kriger, (1988) ibid, p 198

Figure 8: New Framework for Subsidiary Governance of International Canadian Banks



(Source: Own design, based on Hilb)

Kriger and Gillies may thus find that their conclusions while completely opposite, may actually be compatible if the subsidiaries they studied are re-examined in the context of a need for market responsiveness, global integration, and worldwide mandate.

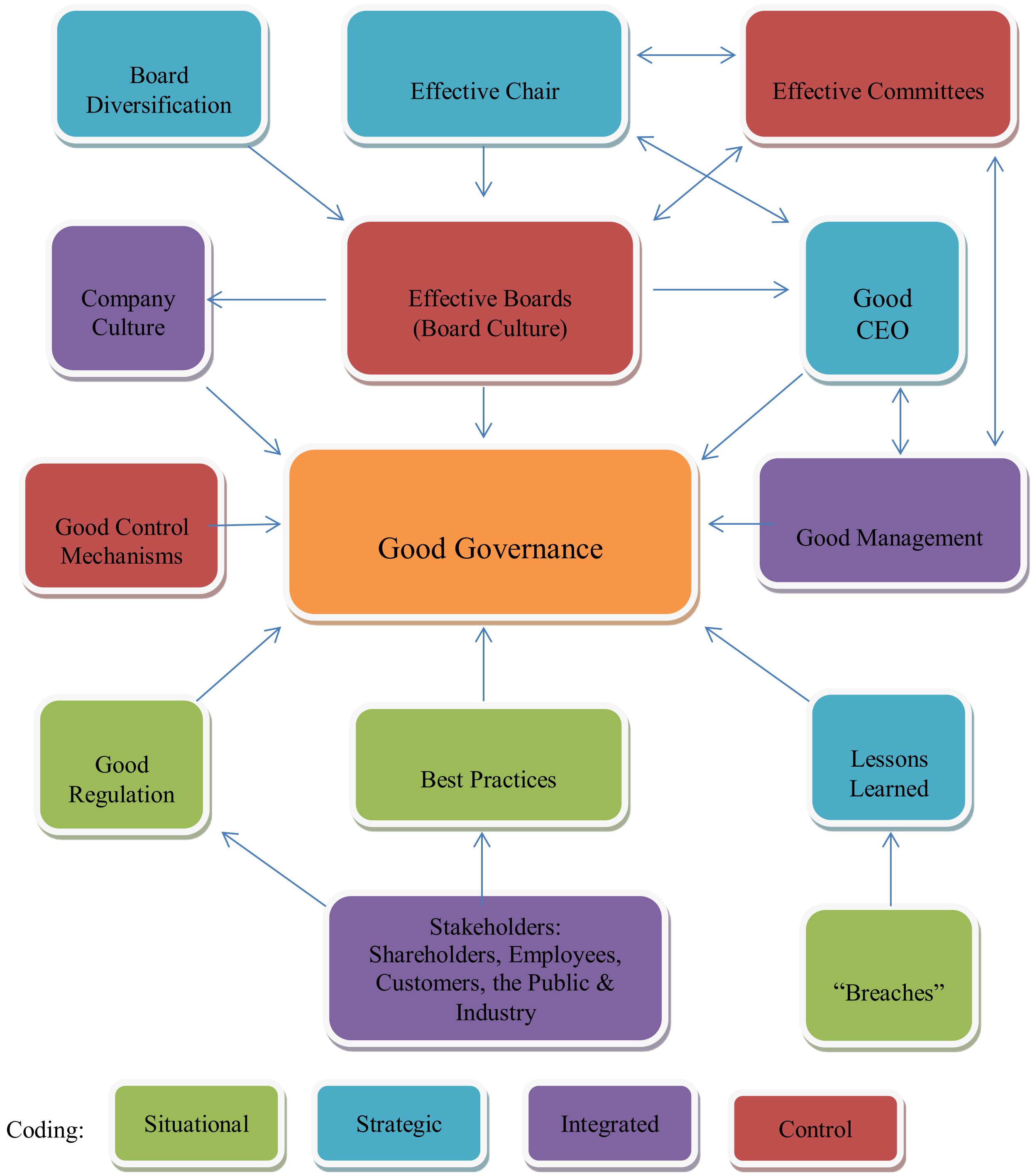
The controlling function of the board is quite critical, especially in a bank, and in this case the controlling methods are complicated by the nature of the internationalization of subsidiaries. Hilb's "Reversed KISS" principles present some possible means of generating effective governance in international banks and their subsidiaries. By collectively keeping it situational, strategic, integrated and controlled, I will demonstrate how Canadian banks are following best practices for new corporate governance and serving as leaders in the world of international banking.

2.5 New Framework for Subsidiary Governance of International Canadian Banks:

With the above research in mind, I can now begin to sketch out what an effective framework for subsidiary governance of Canadian international banks would look like. It would fundamentally include an orientation to both shareholders and stakeholders and incorporate Hilb's "Reversed KISS" principles for glocal direction and control. Figure 9 illustrates this framework. It is important to highlight that stakeholders exist at the parent level and subsidiary levels; to be effective, the main subsidiary boards must mutually recognize and accommodate both groups of stakeholders. As mentioned earlier, stakeholders of an international subsidiary include the local regulators and the public in the host location. In recognizing these stakeholders, boards need to give consideration to the unique regulatory and cultural issues that differentiate the subsidiary location from the parent's home market.

Complimenting this subsidiary framework is a macro theoretical model that provides a structure and the component elements in the Canadian bank system that generates good corporate governance for these banks. It is this theoretical model (Figure 9 - "Good Corporate Governance Model" for Canadian Banks) that will be tested in my empirical analysis. Each section of Figure 9 is coded according to my qualitative methodology. The four structuring fields present a holistic assessment of corporate governance at the uppermost level of an organization, consistent with Hilb's new corporate governance framework. Consistent with qualitative research, as the analysis proceeds, this model will be examined and refined as necessary.

Figure 9: "Good Corporate Governance Model" for Canadian Banks



(Source: Own Design based on Hilb)

Following the theories proposed by Hofstede and Hilb, I later conclude (Section 3.5 – Research Findings) by presenting a unified framework that links the needs of the local stakeholders with the global needs of the shareholders with mechanisms that ensure effective organization control, international communication for local and global understanding, and monitoring processes for enterprise-wide needs. Considering the complexity of the products and services the Canadian universal banks offering in so many international jurisdictions, a framework for effective control that links stakeholder needs with the local needs of the shareholder is of critical importance for governance of these banks.

2.6 Conclusions from the General Theoretical Section:

This dissertation began by presenting the widespread issues that arise when corporate governance in ineffective. This was observed generally, relative to organizations as a whole, and specifically with crises involving an international subsidiary. I also reviewed the recent global financial crisis and the critical impact that banks can play if breaches of governance are not prevented. It is abundantly clear that governance of banks is of the utmost importance. In examining this sector, I noted that the Big 5 banks in Canada have been highlighted for their recurring stability, despite all having material international operations. I thus argued that there is merit to exploring the particular governance practices these institutions employ relative to their international subsidiaries. A qualitative research methodology fostered this work..

Section II reviewed the history and evolution of this relatively young subject. As I traced the history of major global crises, I demonstrated that authorities responded almost habitually to these events with new regulations. I also presented the research of the Clarkson Centre for Business Ethics and Board Effectiveness to demonstrate that regulations do in fact bring about changes in companies. However, as the most recent global economic crisis demonstrated, new governance regulations alone cannot prevent businesses from collapsing or additional crises from occurring. There are limits to regulation.

I therefore turned to examine the so-called human dynamic—a side of the human psyche that views misdeeds and fraud as acceptable behaviour under specific conditions. Though not specifically central to this research, Dan Ariely's recent social research may be discovering new ways to influence the human dynamic for the betterment of governance. There may be important findings for companies and boards to learn from social research of this kind so that they can modify organizational behaviour and produce new methods to ensure good corporate governance.

A discussion of the regulatory framework for financial services in Canada followed and I reviewed the complex web of regulations that surrounds the banking industry. By highlighting the various other governance environments that exist on an international scale, it was evident that the regulatory jurisdiction a given bank falls under is multiplied for every international location that they enter.

Irrespective of any regulations that may be in effect at a given time, I argued that it was ultimately a company's board of directors who had the legal and moral responsibility to shareholders and stakeholders; it was up to this group to achieve management oversight and good governance. With the complexity of increased internationalization, however, boards need to develop new ways of thinking about and approaching corporate governance. I believe Hilb's new corporate governance model is the best way for international businesses to proceed if they want to be truly *glocal*. For only by following Hilb's four principles—Situational, Strategic, Integrated and Control—can boards have a roadmap for glocal control and direction for their international businesses. "Reversed KISS" is subsequently my chosen model for examining Canada's international banks, their subsidiaries and their subsidiary boards.

I concluded Section II by presenting two frameworks. The first was my new framework for subsidiary governance of international Canadian banks (figure 9). This model accurately expands Hilb's new corporate governance, which was designed to assess international companies in general, and expands it to fit the unique structure and function of Canada's international banks. The second framework, entitled "Good Corporate Governance Model" (Figure 9), is a dynamic methodological lens that I use to guide my qualitative analysis and identify the component parts of "good governance" at the parent level of these banks. From there I will examine international subsidiaries and develop a final model called "Transcultural Conduits" (Section 3.5 - Research Findings). This holistic framework will allow governance scholars and practitioners to apply the best practices of Canadian international banks to the broader world of corporate governance and create positive change in organizational environments.

There is a tremendous amount of interest in my research covering both academics as well as with banking executives and board directors. As will be presented in my Empirical section, I was able to interview executives and directors from all of the Big 5 banks. As well, Canada's chief regulator participated. And other esteemed industry individuals (Sir David Walker, and Robert Pozen) also participated. Everyone I asked for an interview agreed to participate—they were all intrigued with this research and freely gave me hours of information and opinions. Their interest gives me confidence that my research has real industry merit.

Part III: Specific Empirical Section:

3.1 Empirical Objectives:

Two of the most important outcomes of good governance are stability and sustainability. Canada has been rated by the World Economic Forum as having the "Most Stable Banking System"1 in the world for the last five consecutive years. It is safe to conclude then that good governance practices must be in play within these banks as well as the Canadian banking industry. But the question remains: what is it about the Canadian banking system and Canada's banks that generates governance success both in their domestic operations as well as into their international subsidiaries? Can these best practices be extended to other Canadian companies or to banks in other nations?

The overall objective of my research is to obtain new insight on the good corporate governance practices of Canada's international banks and how these practices extend into their international subsidiaries. The empirical objective of my research is to not only generate theories and observations, but also to ensure that these conclusions can be credibly and reliably applied to other areas of international business.

Studying the Canadian banking system's governance practices is valuable in better understanding how these banks have achieved good corporate governance. There may well be lessons for other international banking systems and stakeholders located outside of Canada. I also propose that there may well be benefits to other (nonbanking) international companies in Canada and perhaps even to international (nonbanking) companies located outside of Canada. If my conclusions are of value to any of these wider audiences, this research will have even greater value and benefit to the field of corporate governance research.

With these objectives in mind, I realize that my research must be rigorous to ensure the reliability of my conclusions. This rigour will be of paramount importance if my objectives are to be achieved. My conclusions, theories, and observations must be meaningful, but also believable and reliable.

3.2 Target Group of the Empirical Study:

As outlined above, the focus of my research is Canada's Big 5 international banks: Bank of Montreal (BMO), Canadian Imperial Bank of Commerce (CIBC), Royal Bank of Canada (RBC), TD Bank (TD), and the Bank of Nova Scotia (Scotiabank). Appendix B illustrates some of the key fundamentals of these five banks, their boards, and their international operations.

This group was selected for several reasons. First, the Canadian banking industry is well known for its stability. Second while there are seventy-seven chartered banks operating in Canada, the Big 5 are the only ones that have a presence in every province and territory in Canada. These five banks are the largest among the seventy-seven banks and operate 85% of domestic banking branches in Canada. Thirdly and most importantly for my research, these five banks have all operated material international subsidiary operations for extensive periods of time and have international networks that are very mature and well developed. RBC and Scotiabank opened their first international offices in the 1880s. Although there is a broad number of factors and stakeholders that contribute to the WEF's rating of Canada's banks, including the regulatory regime, the other banks and the domestic environment among other factors, the size and scope of these particular institutions means that they contributed most significantly to the WEF's rating.

Additionally, these 5 banks represent a small universe of cases to study, that factor contributes to making my research manageable and more focused. Lastly and importantly, I am a Canadian and a former Bank executive at RBC with over 30 years of service. Fifteen of those years were spent heading various subsidiaries in international locations that these banks operate in. I therefore have a unique understanding and insight of this industry especially as it relates to international bank subsidiaries. I felt that my background would help me obtain access to banking executives and directors and aid in conducting my research. I targeted bank chairmen, board directors, chief executive officers and chief risk officers as well as other key stakeholders or experts (regulators, academics, industry officials) for my research. Being a former bank executive and director of various international bank subsidiaries I was optimistic this target audience would meet with me to discuss this research.

3.3 Research Methods and Design:

3.3.1 Research Approach and Design

As presented in part I, Research Methodology, my research will follow a qualitative research method and use Grounded Theory for analysis. Data collection will be based on interviewing Canada's banking elite in the Big 5 banks. My findings will be triangulated between the banks as well as between board directors and management. My research will be further triangulated by interviewing industry bank experts both in Canada and outside of Canada. Their insights into questions of corporate governance in international subsidiaries are crucial to a robust understanding of the Canadian banking industry.

It may be helpful to other governance researchers to understand the journey I have taken and the barriers I encountered during the formulation of this research so I will briefly sketch what occurred to lead me to my conclusion to follow a qualitative research approach using Grounded Theory for data analysis.

My Proposal (*Vorstudie*) was accepted by my Professors Dr. Martin Hilb and Dr. Beat Burnet at St Gallen University, Switzerland on October 8, 2009. At that time I was still an executive for RBC serving as CEO of RBC's Reinsurance operations in Barbados. In addition to pursuing my doctoral studies at St Gallen's, I was also lecturing part-time in Executive Programmes at the University of Toronto's Rotman School of Management. I freely discussed my research with several professors at Rotman who all expressed interest in my research. Professor Dr. Walid Hejazi suggested that I form an advisory committee in Toronto to help provide feedback on my research. Dr Hejazi seconded Matt Fallbrook, Manager of the Clarkson Institute (CCBE) and Muhammad Umar Boodoo a PhD student from Mauritius, to join and form my current advisory committee. I am grateful for their prodding and advice.

1st Design – Quantitative Research using Internet-based Public Data

My initial intention was to follow a quantitative research approach that would gather publicly available data on the top 100 banks in the world. I planned to pull information from each bank's website and use that data for empirical analysis on what constituted success in effective corporate governance. My plan was to then create a data base of these top 100 banks, and the particular structure of their boards, directors, subsidiaries and subsidiary boards. I would then compare key variables in board and subsidiary dynamics in order to correlate dependant variables like board diversity and board nationalities to various outcomes (independent variables) of good corporate governance in their banks and their international subsidiaries.

To structure data collection, I designed a data framework of possible governance indicators (dependant variables) that I could aggregate and compile for this data base. Appendix 3: Dependent Variables for Successful Subsidiary Governance presents my data framework. This objective of this approach is to determine if a correlation could be made between various features of organizational or board design and good subsidiary governance. For example, two of the variables I proposed to obtain were:

- Do directors of the main board also serve as chair on material international subsidiary boards?
- Are independent directors also appointed as directors to material international subsidiary boards?

After several weeks of research I concluded that the data that I was seeking was simply not publicly available on-line via the internet. I found that information on banks' subsidiaries is significantly scarce online. I also discovered that the information on the banks' web pages on the skills and demographics of Board Directors was quite variable and that no information exists regarding subsidiary board directors. Consistency of information was generally poor as was the transparency and structure of what is being provided by companies. Without a higher quality of data, it would be very difficult to follow a quantitative methodology and produce any meaningful conclusions.

Before fully abandoning this approach, I considered the possibility of obtaining this data through a direct survey to these 100 banks. Numerous methodological difficulties arose with this notion as well. Since I could not expect more than a 20% response rate, even the limited data achieved from this source would not allow me to make credible conclusions with date from twenty banks spread across four to ten countries and regulatory regimes; creating any credible country profile would be unreasonable with only one or two banks responding from a given location. In addition, the effort to send this survey to such a wide audience was considerable given my lack of personal leverage with this target audience. The risk of failure or mediocrity was subsequently very high. After consultation with my advisory committee I decided not to pursue this web-based approach, and instead explore electronic databases as a next step in following my original quantitative design and data elements.

2nd Design – Quantitative Research using International Banking Databases

My first design failed due to a lack of available information on the internet. I decided to keep the same research design, and to pursue other sources for data. In particular I was interested in examining electronic databases where I could download information on the top 100 banks, relative to their boards of directors, their subsidiaries and their subsidiary directors and perform regression analysis on selected variables. Several databases were identified. I arranged meetings and demonstrations with the vendors to explore the datasets they were offering to see if the data I was seeking was available on their databases.

Bankscope – Bureau van Diijk[238]

Bankscope is a leading provider of electronic financial data to researchers, analysts and investors. Bankscope's collects date from rating agencies Moody's, Standard and Poor's and Fitch, as well as other data from the Economist's Intelligence Unit and Capital Intelligence. Bankscope's website claims that they maintain a "comprehensive, global database on 30,000 banks around the world". They also maintain up to 16 years of historical information for each bank and they provide statistical models that produce financial analysis on a daily basis for over 11,000 banks across the globe. With access to financial statements and ratings information, as well as "very detailed information on individual banks"[239], including information on Directors and other contacts within these banks, Bankscope appeared to be a perfect fit for my research.

[238] Bankscope – "World Banking Information Source" - See: http://www.bvdinfo.com/About-BvD/Brochure-Library/Brochures/Bankscope-brochure
[239] ibid

A marketing representative provided me with a detailed online presentation of Bankscope's data and the reporting capabilities of their services. After several discussions and further research however, I concluded that this dataset only contained financial information from corporate annual reports. Since my research required information on subsidiaries as well as much more detailed information concerning board members, board committees and bank directors I concluded with agreement from my Advisory Committee that Bankscope did not provide detailed enough data for my needs.

RiskMetrics - MSCI[240]

RiskMetrics is a database organized by Morgan Stanley Capital International. They track a broad range of instruments including, Commodities, Equities, Fixed Income, FX, Mortgages and Structured Credit. They also monitor banks from a risk/exposure perspective and recently introduced guidelines for their Governance Risk Indicator (GRId)[241] rating system. Although both of these features initially attracted me to this database I soon discovered that RiskMetrics suffered the same limitations that were inherent in Bankscope.

Again after consultation I rejected RiskMetrics due to its lack of information on board of directors and a complete lack of information on subsidiaries and subsidiary boards.

Clarkson Centre for Business Ethic and Board Effectiveness

Still determined to follow a quantitative research design, I received an offer from the CCBE to explore their 10 years of governance data to see if this database could be used for my research. The CCBE is a purely Canadian data base and focuses entirely on the 15 principles outlined previously (Section 2.1.5 - Monitoring Industry Change) for the top 200 companies in Canada While the CCBE data base is rich in board related data there is no tracking of subsidiaries, or any data on Board committees, board diversification, or other relevant company information that pertains to my research. After a very short review I concluded that the CCBE database would not help me to develop theories or

[240] MSCI RiskMetrics – See: http://www.msci.com/products/risk_management_analytics/riskmanager/
[241] ibid

conclusions on good corporate governance as it pertains specifically to Canada's international banks and their subsidiaries. The CCBE was also rejected as a source of data for my research following a quantitative research design.

After three attempts to find electronic databases for my research my Advisory Committee suggested I re-think my research methodology. It was time to utilize a survey to create data.

3rd Design – Quantitative Research via Survey of Board Directors in Canada

I concluded that a survey was likely the only method of gathering my own data in pursuit of a quantitative research methodology. I concluded it would need to be targeted to a very specific audience. Since I was focusing on the Canadian banks, I concluded I should direct my survey to a Canadian audience. I pursued this further.

I carefully crafted questions around the data elements that I needed to capture in order to make relevant correlations between variables. I also focused on the clarity of my questions to ensure that issues of vagueness were avoided (see Appendix 4: New Corporate Governance of International Subsidiaries, Survey of Canadian Companies). The survey was designed to inquire about company financial size, the degree of internationalization, the size and diversity of the board and the roles and interconnectivity of the subsidiary board with the parent company. It also provided a section that offered an opportunity for unstructured commentary on the function of governance in that company and their international subsidiaries. As the questions pertained to the board, its subsidiaries and directors, the target audience needed to be knowledgeable and understand their company's board dynamics and international presence. It was designed to take roughly 20 minutes for a knowledgeable company respondent to complete and was web-based for ease of delivery and return, data compilation and analysis.

After drafting the survey and having it reviewed by several colleagues at St Gallen University and at Rotman, I tested the survey with Mr. Brendan Calder, Adjunct Professor and Entrepreneur in Residence at the University of Toronto, a man who has served on over 20 Canadian for-profit boards. After adjustments, the survey was ready to go. During this processes, my Advisory Committee and I debated a suitable audience for the survey. Finding an available audience proved to be more difficult than anticipated and several attempts at gaining access to appropriate groups failed. My advisory group and I concluded that the best target audience for my survey would ultimately be the Institute of Corporate Directors (ICD) in Toronto, which works closely with board directors across Canada, setting standards and providing education programmes and certification fr directors. The ICD partners with Rotman for the Directors Certification Programme in Canada and works closely with the Clarkson Centre for Board Effectiveness also at Rotman. Both of these factors lead us to believe that the ICD would have access to an ideal set of respondents for my survey and the institute would be interested in participating in this research.

The ICD's CEO, Mr. Stan Magidson was eager to discuss my research and this possibility. We met in his offices on January 18, 2011. Although the ICD was interested in my research, I learned that a great number of surveys are issued to the membership of the ICD and at that particular time four surveys were already scheduled. The earliest my survey could possibly be scheduled was 9 months later (Oct 2011 at the earliest). Since this timeframe was not guaranteed and would likely extend beyond my dissertation's deadline, sending a survey through the ICD had to be abandoned.

After a final discussion with my Supervisor, I decided to abandon the pursuit of a quantitative research programme and instead develop a qualitative study that would use interviews to gather information and grounded theory to analyse it.

Although a considerable amount of time was invested in creating an appropriate and feasible quantitative research methodology, the process itself was extremely valuable. I became more familiar with the availability of governance information on the internet and on institutional databases. I also went through the exercise of structuring several data collection processes and developed a useful survey for on my research subject. Lastly I became very knowledgeable on the use of qualitative research methods and have learned that this method may well be the most useful way to do primary research on corporate governance issues.

Final Design – Qualitative Research via Structured Interviews

Designing a research programme that follows a qualitative research approach required me to complete several new and additional steps, including:

1. Becoming more familiar with qualitative research as a general methodological tool for management research and understand the particular use of Grounded Theory as an explanatory lens for analyzing data;
2. Understanding the ethical issues in qualitative research, paying specific attention to issues like informed consent, principles of confidentiality and other issues pertaining to the conduct of unbiased research and the handling of data collected;
3. Becoming versed in the analytical methods of grounded theory, including the standard tools, software and techniques used for analyzing data and methods for generating conclusions and theories;
4. Strategically structure a research programme that addressed my particular research objectives and the need to target a specific group of interviewees;
5. Design an "Interview Questionnaire" that would be consistent and relevant for all interviews. The questionnaire would need to be short enough to respect the respondent's time but detailed enough to obtain the information I required on banks, boards, subsidiaries and subsidiary boards. It would also need to be tested;
6. Obtain appointments with senior bank executives and schedule the data collection process.

To complete these steps I first familiarized myself with qualitative research by attending a seminar at the Rotman School of Management. I immersed myself in books, including Glaser and Strauss' seminal text on grounded theory called "The Discovery of Grounded Theory: Strategies for qualitative research"[242]. Several other authors helped including Bryman and Teevan, and other academic journals as listed in my References Section. I had the good fortune of receiving crucial advice from academic colleagues, including Doug Hyatt (Rotman), Niamh Brennan (University College of Dublin) and Karen Anderson (York University). Each of these individuals made valuable contributions to my

[242] Glaser B, Strauss A. - "The discovery of grounded theory"- Chicago: Aldine; 1967, 5th printing 2010

understanding of qualitative methodology including the ethical issues of informed consent, confidentiality and research conduct.

To develop my strategy, I proposed to interview a cross section of Bank leaders in Canada. Although it was originally suggested that a minimum of 11-15 interviews be targeted for statistical significance, the higher number was chosen for reliability. I decided to split my interviews between bank directors and bank executives and triangulate the information collected across roles and across each of the 5 banks. For further validity, I also decided to interview industry participants who were not directly associated with any specific Canadian bank.

In researching the Big 5 Canadian banks I decided to obtain an equal number of interviews from each bank and to interview both members of the board as well as executives. Board interviews would be shared between the chair and other directors. Executive interviews would be split between chief executive officers and chief risk officers. I decided to include chief risk officers due to the "controlling" nature of the board and to recognize the importance of managing risk in a governance framework. Two interviews were targeted for each of the Big 5 banks. For industry experts, I targeted Canada's chief regulator of banking, the Superintendent of OSFI plus two others in Canada. I also decided to target two other experts from outside of Canada for an international perspective. Appendix 5 lists the matrix of target interviews and Appendix 6 shows the interviewees and the actual dates the interviews were completed.

According to the principles outlined in grounded theory (see Section 3.3.2 for more detail), my Interview Questionnaire needed two key elements. First, to minimize researcher bias, each of the 15 interviews needed to have exactly the same questions. This meant creating the final questionnaire before I started my first interview. Secondly, the questionnaire needed to be designed to generate data on how these Canadian banks achieve effective governance in their banks and in their subsidiaries. Also in recognizing that my target interviews were high-profiled industry executives, the interviews needed to be one hour or less. I estimated that 15 questions would be enough to fill the hour and broke the questions into three categories: 1) How does governance work at your bank?; 2) How does corporate governance work in your international subsidiaries?; and, 3)

Any other comments pertaining to corporate governance in general or the future direction of corporate governance for banking in Canada or globally?

The draft questionnaire was edited by David Beatty, head of the Clarkson Institute and also a board director with Bank of Montreal. With Mr. Beatty's advice we edited and strengthened my Questionnaire. The revised document was shared with my supervisor Dr. Martin Hilb and others for review and it was approved. Appendix 7 provides my final interview questionnaire. As the final step in this process, Mr. Beatty in his capacity as a Director at BMO, agreed to serve as my first official interview. It lasted 47 minutes. The questionnaire was deemed ready to go.

I also examined the availability and practicality of using a software programme as an aid in data analysis. I researched the two most popular qualitative research software packages – Atlas Ti and N-Vivo. Both have strengths and weaknesses depending on the application. Atlas Ti[243] for instance was developed in the UK and is the preferred methodology for universities and researchers there. N-Vivo9[244] (formally called NUD*ST 6) is an Australian programme and quite popular in Europe and North America. I ultimately selected N-Vivo for my research, because of its intuitive Windows-like interface and functionality as well as the strong endorsements gathered from experienced researchers at the University of Toronto's Ontario Institute for Secondary Education (OISE – Olesya Falenchuk) and at the University College of Dublin (Collette Kirwan).

To summarize, my overall research design would now follow a qualitative research strategy, using grounded theory and N-Vivo for data analysis, and be based on 15 structured interviews asking open questions that allowed for free-flowing answers. With this structure decided, I was ready to start my research. Before examining the findings from this research, it would be useful to explain the specific rationale and issues behind grounded theory and the methodology I followed for data analysis.

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[243] Atlas ti: "The Qualitative Data Analysis and Research Software", See: www.atlasti.com/
[244] NVivo, "QSR International", See: http://www.qsrinternational.com/

3.3.2 Grounded Theory Methodology

3.3.2.1 Rationale for using Grounded Theory

In 2011 the International Hospitality Research Centre in Switzerland (IHRCS) published an article titled: *Research methods for Business – Analyzing qualitative data*[245]. In it the author indicated what she believes are the five keys to success in analysing qualitative data:

- An intimate knowledge of the data itself;
- A comprehensive understanding of the culture within which the problem occurs;
- A record of the problems and issues that were addressed in the data collection process;
- A thorough knowledge and understanding of the relevant theoretical frameworks;
- The method selected must be appropriate to these contextualising factors, and most importantly, to the type of questions for which findings are sought.

Based on these criteria, I was comfortable with this research method. My extensive executive experience in international financial service for a major Canadian bank plus in performing this research myself, made me confident that I had an intimate knowledge of the data.

With this meta-methodology in place, the next step was to decide which particular qualitative research strategy would best suit my research goals and requirements. Of the fifteen possible choices that Straus[246] indicates it is clear that many did not apply to a research method that needed to rely on interviews. I concluded that many the best data analysis method for an interview-based research project was grounded theory because it allows a researcher to perform comparisons and contrasts to the data provided by interviewees. My conclusions on using Grounded theory were supported by recommendations I had received

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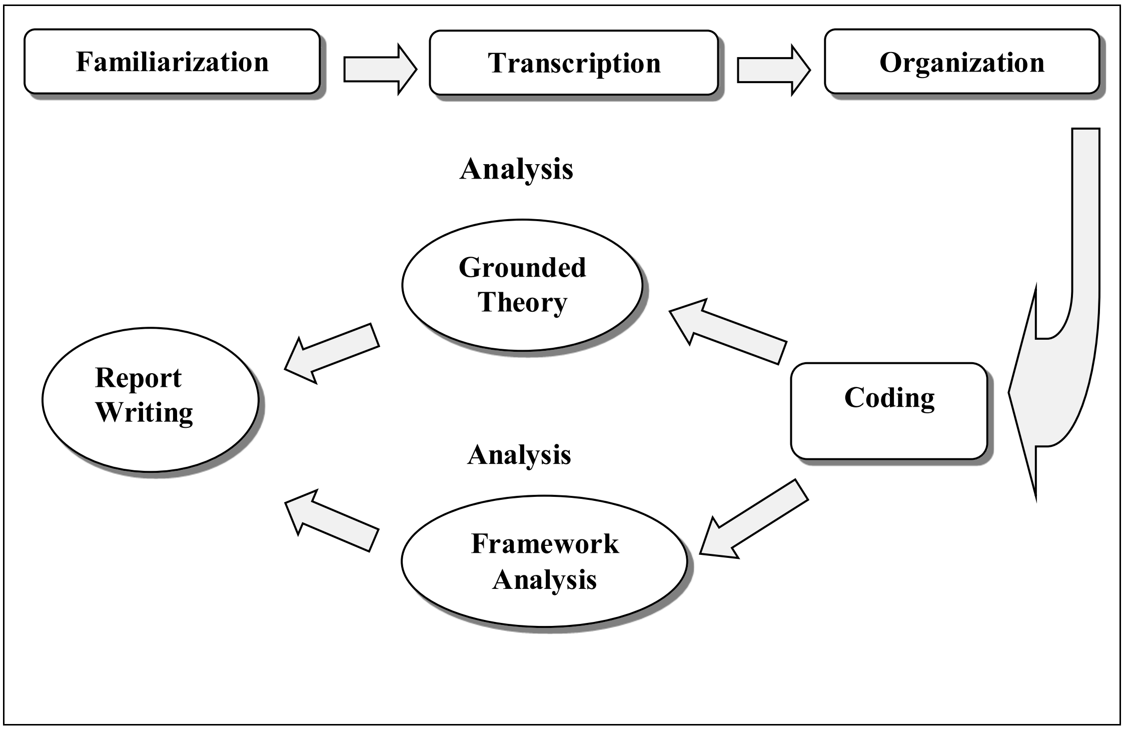
[245] IHRCS - “Research method for Business – Analyzing qualitative data” – See: http://www.ihrcs.ch/?p=87
[246] Strauss, A. - “15 Methods of Data Analysis in Qualitative Research” , Analysis (2004) Vol. 3, Issue 3, Publisher: CiteSeer, pp 1-32

from research colleagues that I contacted at the University of Toronto (Doug Hyatt), York University (Karen Anderson) and the University College of Dublin (Niamh Brennan).

Figure 10 - Stages in Qualitative Data Analysis



(Source: Lacey & Luff - 2001[247])

According to Strauss a grounded theory approach to qualitative analysis requires that the researcher to:

- Create documents (such as field notes, or transcriptions of interviews);
- Look for categories of behavior and name ("code") them on documents;
- Compare codes to find consistencies and differences within the findings;
- Use codes to build consistency and allow for "categories" to emerge;
- Straus warns that using qualitative research software may or may not be helpful within a grounded approach but suggests that N-Vivo is the best in this regards, which pleasingly supports my own prior conclusions;
- Examine the comparisons and emerging categories to create explanations and theories;

[247] Lacey, A. & Luff, D.,(2001). *"Trent Focus for research and development in primary health care: An introduction to qualitative analysis",* Trent Focus (UK)

- Categories are saturated when no new codes emerge in the analysis
- Locate key themes to identify axial or core categories: theories and observations emerge from these.

The key to this process is to find patterns and consistencies in the responses themselves, so that the theories that emerge are “grounded” in the data. The codes and categories that develop as I compare and contrast information received from respondents are what form the conceptual building blocks of this approach. With these interviewees established and with my enhanced understanding of this area of research, clearly grounded theory is the most appropriate method for my data analysis. Figure 10 provides a graphic explanation of the iterative approach for grounded theory and framework development. I am now prepared to commence my qualitative research strategy.

3.3.2.2 Rigour in Applying Grounded Theory

In a Grounded Theory approach all explanations or theories emanate from the data itself rather than from the researcher's prior theoretical viewpoint.[248] In qualitative research attention to rigour is critical because it helps ensure that conclusions are reliable and relevant to the object of study. In the prior two sections I outlined the approach I will take to obtaining information and the reputable resources I will be using. I have also outlined the steps I will take to carefully analyze this data. In addition to adhering closely to the processes outlined in my research design, what else might a researcher do to increase the rigour of a qualitative research project that follows Grounded Theory for data analysis?

There are several additional steps researchers can take to increase the rigour of their qualitative research and in so doing increase the reliability of their conclusions and the significance of their research. In her journal *Checklists for Improving Rigour in Qualitative Research*[249] for the British Medical Journal, Rosaline Barbour identified the weaknesses and criticism associated with qualitative research and three critical actions that a researcher can undertake to

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[248] Glaser & Strauss - ibid

[249] Barbour, R. - “Checklists for improving rigour in qualitative research”British Medical Journal - 2001 May 5; 322(7294): 1115–1117

improve the rigour and accuracy of research projects that use grounded theory for data analysis. They are: Purposive Sampling, Multiple Coding and Triangulation. In my research on the corporate governance of international banking subsidiaries, I sought to ensure that all three were materially present in my research design.

Purposive Sampling:

Qualitative research often relies on convenient samples, particularly when the target research group is difficult to access. Purposive (or theoretical) sampling, subsequently offers researchers a degree of control because they can deliberately seek to include outliers that are typically dismissed in quantitative approaches.
In my research I have targeted highly specific interviewees for my research. They include the board chairs, directors, chief executive officers and chief risk officers of Canada's largest banks. By being limited to a certain number of possible respondents, the reliability of my research was increased because it remains focused on those who are knowledgeable, experienced and active members in the governance community. This purposive sampling, as Barbour calls it, actually serves to increase the reliability and therefore the rigour of my research.

Multiple Coding:

Multiple coding involves cross-checking of coding strategies and interpreting data by independent researchers. This effort is the equivalent in quantitative research as inter-rater reliability[250] and it is a response to the charge that subjectivity sometimes levels the process of qualitative data analysis.

Before starting my data analysis I sought an independent review of my coding structure from Dr. Olesya Falenchuk, the Qualitative Research software analyst at the Ontario Institute for Secondary Education (OISE) at the University of Toronto. Although no modifications were made at that time, it was clearly evident that as I evolved my analysis I would need to continually review my coding structure as outlined in Figure 10, and make changes whenever it became evident that my original design needed to be modified.

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[250] ibid

Triangulation:

Triangulation addresses the issue of internal validity by using more than one source or method of data collection to seek insight to a particular research question. In my research, triangulation will occur at four separate intervals:

1. Between board directors (board chairs and directors) and executives (CEO's and CRO's)
2. Between the five banks themselves to see how banks agree and disagree concerning their methods for corporate governance.
3. By examining the answers provided by the banks and comparing these replies to those I receive by the panel of Canadian banking experts. This panel will include Canada's chief regulator of banks, an academic, and the head of the Canadian Banker's Association.
4. Obtaining views from outside of Canada from the two non-Canadian bank experts: Sir David Walker (UK) and Robert Pozen (US) who will provide an expert and independent perspective of the Canadian banking industry, its ratings and its governance practices.

Conclusion:

In conclusion I will ensure my research adheres to these principles of rigour by following the research methods outlined above. I will also ensure that my research practices and processes follow the principles for a qualitative research design using grounded theory for data analysis. In the end it is important that my research adheres to these strict principles to ensure that my conclusions developed from it have merit and applicability to other industries inside Canada, as well as to other banks and other banking regulators outside of Canada.

3.3.3 Research Procedure

3.3.3.1 Interviews

Target Selection

In section 3.2, I presented my targeted selection of interviews. It is important for this research to meet these individuals for three reasons: 1) the Questionnaire was very specific on governance and their international franchises – these senior people are uniquely qualified as they have a holistic perspective of governance in their banks and all of the subjects I will be exploring; 2) these senior long-term employees would also have the historical perspective of the evolution of Corporate governance inside their bank and would bring both a macro and micro understanding of the workings of governance in their bank and the industry. As well, being senior and seasoned executives and directors, they would be comfortable in speaking to me whereas a more junior or less experienced person might be more guarded; 3) my research needed a cross-section of directors and bankers in all five banks to participate. Each interviewee was advised of the other bank executives and directors on my interview list. This provides me some comfort that this is a built-in control to ensure that their responses were accurate and not exaggerated, further increasing the reliability of the replies.

From a researcher's perspective these are excellent people to target, however from a practical perspective their time is very valuable and scheduling an hour of their time might be difficult. Although I was once an executive of RBC and quite well known in this one bank, I would not be familiar to Executives and Directors in these four other banks. In the paragraph that follows I present the process of establishing my interview schedule.

Intermediation, Introductions and Scheduling

One potential risk to my research was in obtaining an hour of time from these 15 very senior and very busy people. By good fortune I encountered five of my interview targets well before my interview schedule started, at different industry or social gatherings. In these occasions I took the opportunity to introduce myself and my research topic and asked for a meeting to hear their views. To my delight all five agreed and gave me instructions on how to contact them. I am very grateful to John Thompson, then chairman of TD Bank, Gerry McCaughey CEO of CIBC, Robert Pozen, lecturer and author of Harvard Business School, John Mayberry, Chair of Scotia and David O'Brien, Chair of RBC for agreeing early in my interview schedule to meet with me. I am certain that their early support helped influence several of the remaining interviews I needed to also meet with me.

Also, during my research on the Clarkson Institute, David Beatty the head of the Institute and also a board director at BMO expressed his willingness to assist my efforts if needed. As previously explained, I first called on his support in the design of my Questionnaire. During that process he further agreed to be interviewed as a Board Director of BMO and to serve as my first interview to help me test the questionnaire as well as my interviewing process. Additionally Beatty helped me through his extensive network of industry contacts to set up other interviews. His support was invaluable in securing many of my interviews but also in ensuring the quality of my interview process.

To ensure I had proper representation across all five banks and reasonable diversity of views I decided to seek interviews with 3 Bank Chairmen, 3 Board Directors, 2 CEOs and 2 Chief Risk Officers. To assist my scheduling, I created a matrix of “Target Interviews” across the Big 5 banks which is displayed as Appendix 5.

Table 12: Schedule of Interviews

Date:	Interviewee:	Title:	Organization:
May 26, 2011	David Beatty	Director	BMO
June 1, 2011	Gerry McCaughey	CEO	CIBC
June 5, 2011	John Thompson	Director	TD Bank
June 20, 2011	John Mayberry	Chairman	Scotia Bank
June 28, 2011	Morten Friis	CRO	RBC
June 30, 2011	Robert Pozen	Bank Expert	Harvard, US
Aug. 24, 2011	David O’Brien	Chairman	RBC
Aug. 29, 2011	Nick LePan	Director	CIBC
Sept. 15, 2011	Mark Chauvin	CRO	TD Bank
Sept. 22, 2011	David Galloway	Chairman	BMO
Sept. 22, 2011	Terry Campbell	Head	Can. Bankers Assoc.
Sept. 29, 2011	Rick Waugh	CEO	Scotia Bank
Sept. 29, 2011	Dr. R. Leblanc	Academic	York Univ.
Oct 12, 2011	Sir David Walker	Bank Expert	London, UK
Oct, 21, 2011	Julie Dickson	Head	OSFI

(Source: Own Design)

With my first 6 interviewees confirmed, the remaining 9 interviews followed a pattern of someone serving as an introducer to the target interviewee. I am particularly pleased and somewhat surprised that every person I approached to be interviewed agreed without hesitation. I am grateful to all of my interviewees and especially my intermediaries who assisted in securing this very illustrious group of individuals to participate in my research.

Table 12 outlines my Interview Schedule.

Written Request, Outline, CV & Confidentiality

My requests for interviews were conducted by e-mail. In my request two additional points were highlighted: First was the promise of confidentiality. As a result readers will observe that no interviewee or organization is directly named or quoted based on his or her replies to this research interview[251]. Secondly was my offer to send a copy of my transcribed notes which they could read, edit for errors or confidentiality issues and formally approve back to me for use in my research. These two additional points served to address key ethical issues including informed consent, minimizing researcher bias, and to underscore the importance of confidentiality and to strengthen the integrity of my data.

Appendix 8 is an example of an e-mail request (to Nick Le Pan, Board Director of CIBC). Once the interviewee agreed to be interviewed I then sent a second e-mail, confirming our appointment for the interview and outlining in more detail the nature of the discussion. In this e-mail I also included my CV. Appendix 9 is an example of the second e-mail, Appendix 10 is the outline of our discussion, and my Curriculum Vitae is appended at the end of this dissertation. Typically I also dealt with an Executive Assistant – in these cases, roughly 2 days ahead of the meeting I sent a further e-mail to the Executive Assistant to re-confirm our upcoming meeting and ensure no conflicts had arisen.

Interview process and personal interchange

In the majority of cases, the interview was conducted in a boardroom of the interviewee. Being a familiar location the environment would be a source of comfort for the interviewee. In these cases I would undergo the usual building security. I arrived 15 minutes early in every case to ensure I was available when

[251] There is one exception to this – Julie Dickson, the Superintendent of OSFI who agreed to an additional question outside of this research regarding governance practices as they pertain to family owned publicly listed companies (Power Corp). This is discussed in Section 4 regarding “Areas for Further Research”

the interviewee was free. There were four exceptions to this scenario – two interviews were conducted by telephone (Pozen and Dickson) and two interviews were conducted in off-site public locations (Mayberry and Leblanc).

In all cases I started the interview with the usual business cordialities which when possible included an exchange of business cards. My objective at the outset was to make the interviewee comfortable. Also at the outset I re-confirmed we had an hour for the interview. In two cases I was advised time had to be slightly shorter (Friis and Walker). In respect of the interviewee's valuable time, I managed the interview to accommodate their schedule.

I requested permission to record the interview and in all cases that approval was granted. I opened the interviews by repeating the intent of the research, having a focus on the international subsidiaries of Canadian banks with a focus on governance of the banks and how that extends into their international subsidiaries. All interview recordings are still preserved.

Upon reflection I found every interviewee was to be engaged, charming, frank, truly insightful and very knowledgeable. I did not sense in any interview that the interviewee was in any way manipulating their replies either to promote their bank or to hide any issues. All were very forthcoming about problems that they had encountered in their respective banks, how they resolved these issues and their lessons learned from these negative experiences.

To close the interview I reconfirmed that I would send the interviewee a transcript of the interview within 2 business days, for their review and approval. I thanked them for their time. In every case I felt the interview was positive, professional and cordial. Appendix 6 provides my completed Interview Schedule and Appendix 7 provides a copy of my Interview Questions.

Transcriptions & Written Approvals

I used my interview questions as a template, personalize with the interviewee's details plus the and date and time of the meeting, to transcribe the interview recording into document form. I returned all transcription within 2 business days with two exceptions when I had two interviews on September 22, 2011 (Galloway and Campbell) and September 29, 2011 (Waugh and Leblanc). In these cases I warned the second names (respectively) that their transcripts would be delayed.

The Transcription process took roughly 1 day to transcribe and another to edit and revise. By using the software programme Dragon Naturally Speaking[252] I was able to repeat the roughly 60 minutes of audio into a microphone directly into text in a Word document. The 60 minute interview typically transcribed to roughly 14-15 pages of text. One interview was as short as 10 pages (45 minute interview), while the largest transcript was 24 pages (1 hour 45 minute interview). In total I have documented 283 pages of hardcopy interview notes.

I returned each transcript via e-mail to the interviewee for their review comments and approval. While the transcript was a verbatim document of their replies, I requested that they review the transcript to confirm that it reasonably represents their views on each question. I also requested corrections, deletions or areas of confidentiality that I would need to be aware of. In the end, only references to personnel matters (employees being fired after committing a fraud) were requested to be deleted. All interviewees provided their confirmation, some with minor changes, except for four participants which I did not pursue.

3.3.3.2 Documentary Sources

In preparation for these interviews and also to become even more familiar with these banks, I referred to numerous documentary sources.

My first port of call was each bank's annual reports. In this case I was seeking the Management team Structure and names of the executives. As well I reviewed the Board directors, the Board Committees and the size and diversity of the Board. I also looked for insight to the role that governance plays in the bank in both the Chairman's message as well as the CEO's message. I then reviewed the listing of material subsidiaries reported in each bank's Annual Report. These various pages and charts were with me during the interviews and often served as a source document for the interviewee. From these reports I created Table 8 – Comparing Canada's Top 5 International Banks – as at Oct. 31, 2012.

[252] Nuance Corporation - "Dragon Naturally Speaking" – See: http://www.nuance.com/dragon/index.htm

I also reviewed the Bank's web sites, especially looking for references to Corporate Governance. In each of these Big 5 Canadian Banks there is a dedicated link for corporate governance to take the viewer to various bank documents and processes surrounding governance. Also current items of news on the banks' international subsidiaries were also available in the Investor Relations' sections, such as reference to a recent international acquisition (Bank of Montreal) or international disposition (RBC). These matters would undoubtedly be mentioned in the interview.

Time was also spent on investigating the backgrounds to each of the 5 banks' board directors where I was particularly seeking insight to the international diversification of the Board. Quarterly Reports were also reviewed for current events that might be of interest as well as the Annual Proxy Circulars, examining any trends in Shareholder voting or other changes, such as "Say on Pay" which was an active subject for all of the banks starting back in 2010.

Also in preparation for the interviews of my industry expert group I read Robert Pozen's Book *Too Big to Save*?[253], Dr, Richard LeBlanc's book *Inside the Boardroom*[254] as well as the summary and excerpts of *The Walker Review*[255]. These proved to be useful in preparing to meet these experts. Similarly I reviewed recent speeches by OSFI[256]. I also reviewed various other publications and brochures published by both OSFI and the Canadian Banker's Association in preparation for these interviews.

Lastly the internet was of great value in researching any comment made during an interview where I did not want to interrupt the interviewee in his/her response by seeking further clarification. One example was a reference made when OSFI first identified the need for banks to ensure that corporate governance extended to their international subsidiaries; my research showed that this was first mentioned in OSFI's 2002 Corporate Governance Guideline. Another was a reference by one bank on a fraud they experienced in one of their foreign subsidiaries. Similarly, many of my interviews made recurring reference to both

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[253] Pozen, R. - ibid
[254] LeBlanc, R. - ibid
[255] The National Archives, HM Treasury – "The Walker Review" - See http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/walker_review_information.htm
[256] OSFI – "Remarks by Ted Price to the Canada-UK Colloquium on Global Finance" London England, 2009

Dodd-Frank and Basel III which prompted me to research further both pieces of legislation to ensure I had full appreciation of the context that the interviewee was presenting.

These were other documentary sources to prepare for these interviews including numerous academic journals and my literature review (See References) that I examined in detail as part of my overall preparation for this research project on corporate governance of international subsidiaries.

3.4 Limitations of the Empirical Study:

There are four potential limitations of this Empirical Study:

- Limitations of my Research Design
- Limitations of Qualitative Research
- Limitations of Grounded Theory
- Limitations of the Target Industry

Limitations of my Research Design

One key limitation of my research methodology is that I will be following a top-down approach by interview top executives and board directors that oversee these Canadian banks. I will not be interviewing subsidiary directors or subsidiary executives. This is a limitation on the scope and approach of my research and will restrict my conclusion to those who operate at the parent organization and how they see governance extended to international subsidiaries.

As discussed earlier, the research conducted by Kriger, Gillies, Kiel, and Du all focused on the subsidiaries' perspective, or bottom-up research. While it is my view that overall governance rests with the main board, and that management has responsibility for creating the strategies that give life to these subsidiaries, my research is limited by my approach of seeking views from the top of the bank. As we have seen with Kriger, Gillies, Kiel and Du, valuable insight on local responsiveness and other material findings could be missing or understate in my conclusions.

Limitations of Qualitative Research

As presented in Section 1.3 by following a qualitative research strategy requires researchers to recognize the increased need for reliability, replication and validity[257]. *Reliability* refers to the limitation brought on by interviewing these limited number of people and encountering only their perspectives. Quantitative research is well founded in history and the reliability factors using representative samples are well understood mathematically. In qualitative research, those confidence factors are less well defined and therefore less well understood.

The second limitation of the research is the issue of *replication*. Qualitative research takes a snapshot at one point in time. Things change. The industry changes (regulation, etc.), the biases of the interviewees change and changes can occur in either these banks domestic and international environments. How someone might answer a question one day may be slightly different another day. That slight difference may be material to the researcher's findings. Similarly, there is a built in subjectivity in how the researcher interprets his or her findings. Critics of qualitative research argue that the inability to completely replicate a study and the findings of a qualitative research programme is a critical limitation in the world of research. Replication is a limitation.

Validity speaks to the ability to extend the conclusions of the research to another body, beyond the groups that has been interviewed. Will the theories be transferable to other banks or industries? Often in qualitative research the findings may be true for the group that has been studied, but may not apply to another group or in my case another industry or country. Validity is a serious limitation of qualitative research.

Limitations of Grounded Theory

There are several limitations to the use of Grounded Theory as a tool for data analysis. First, as in qualitative research there is a tremendous degree of subjectivity. Researchers are free to choose what becomes a "code", what is recognized as a "category" and how these come together to formulate theories. These are based simply on the interviews and other contextual data, subjectively selected by the researcher to formulate an observation or a theory. Observations

[257] Bryman A. and Teevan, J. (2005) – "Social Research Methods", Oxford University Press, 2005 p 25

can be easily challenged. This again underscores the need to increase the rigour of the research process by using Purposive Sampling, Coding and Triangulation, as mentioned previously.

Other critics of grounded theory challenge whether grounded theory actually generates theory maintaining rather that it simply generates concepts or observations. Bryman and Teevan advise that researchers who use a grounded theory approach for data analysis need to be aware of these criticisms[258] and limitations of using this data analysis approach.

Limitations of the Target Industry

Another limitation of my research is the highly specialize target industry I have selected to research. My goal is to add to the body of knowledge on corporate governance of international subsidiaries. Although I am focusing on Canada's bank's my objective is to seek conclusions that might be useful for example to US businessman Bernie Murdock to explore what he might have done differently from a governance perspective to ensure that the News of the World in London England did not damage his entire global empire and eventually be closed. Similarly, I hope my research might be of value to the Italian milk giant Parmalat to reflect on what they might have done differently to ensure they did not experience a scandal from their operations in the Cayman Islands.

By using the Canadian banks and banking system as my research focus, my findings will be limited to these Canadian banks. Although I fully expect that some of the best practices I will observe will have application outside of this heavily regulated industry that operates in an oligopoly and is headquartered in a country that is rich in natural resources such as Canada. My intention is to produce observations and theories that are meaningful to other industries and other nations. This is a limitation of my empirical research that I look forward to examining at the end of my conclusions.

[258]Bryman A. and Teevan, J. i bid – pp 288-289

3.5 Research Findings

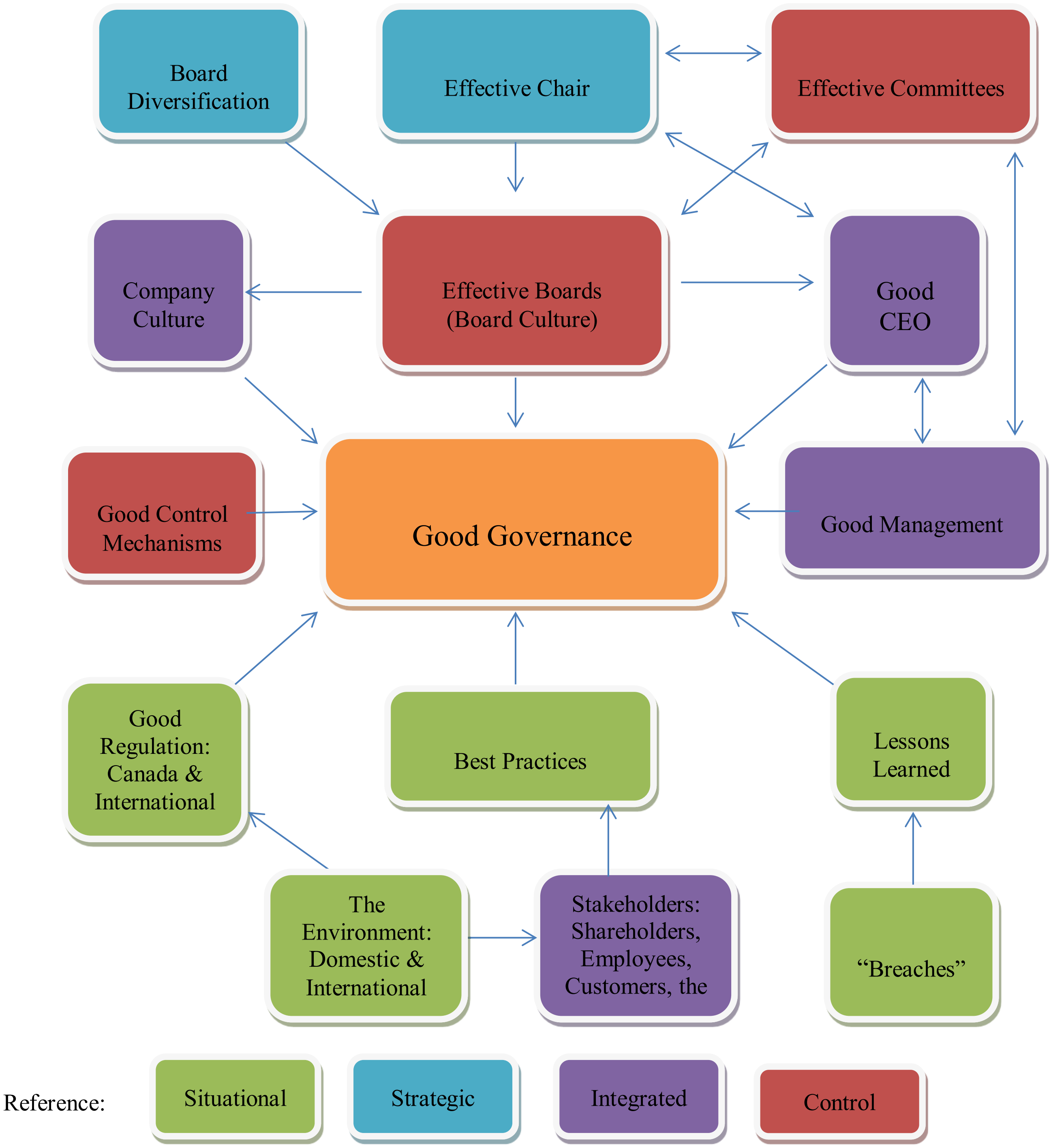
Data analysis using grounded theory requires the researcher to identify codes. These are highlights within a text or transcript that focuses on a key comment made by an interviewee that the researcher wishes to recall later in the analysis. These codes (comments or citations) can then be joined with other similar comments by other interviewees (subcategories) and subsequently they start to form major themes (categories). From this latter group, observations and theories begin to evolve.

My first goal in this research was to seek insight on how each bank effectively achieves corporate governance within the bank with attribution from the main board. Once established, I would then examine how governance is extended into their international subsidiaries. Before I started my coding and analysis, I reviewed the comments made by my interviewees to better understand what they believed created good corporate governance. Following their lead I then theorized that the following twelve categories seemed to play a role in generating effective corporate governance for these banks. What follows are my initial views for Categories to be explored in my research. Grounded theory allows the researcher to modify his findings as he progresses his research and later that did occur with me, resulting in the following being labelled my "initial" list.

***"Initial"* Grounded Theory Categories for "Good Corporate Governance"**

- Effective Board
- Effective Chair
- Effective Committees
- Effective CEO
- Effective Management
- Good Control Mechanisms
- Effective Regulation
- Company Culture
- Best Practices
- Lessons Learned
- Breaches
- Stakeholder Input (incl. Shareholders, Employees, Customers, etc.)

Figure 11: Revised "Governance Model" for Canadian Banks



(Source: Own Design based on Hilb)

As my coding process unfolded and categories started to form patterns I organized my analysis into a visual representation of how this data contributed to what I termed “good corporate governance” in an international bank and its subsidiaries. My revised framework for good governance of Canada’s banks can be viewed as Figure 11: Revised Governance Model for Canadian Banks.

Before completing this exercise I next compared my model to Hilb’s Reversed KISS Principles (reviewed previously) and re-examined the codes and categories under an integrated framework that included Hilb’s framework. By introducing Hilb’s “Reversed KISS Framework” to my “Good Corporate Governance Framework” my codes could be sorted into Hilb’s 4 principles: Situational; Strategic; Integrated; or Controlled. As Hilb’s Framework included several other key categories I revised my frameworks and expanded it to include such items as “Targeted Board Selection” as new Categories or sub-Categories within my “initial” group of Categories By integrating these two frameworks, two material changes were made that led to the revised model in Figure 11:

1. To be consistent with Hilb’s Framework, my Categories “Good CEO” and “Lessons Learned” needed to be re-classified. I had originally labelled “Good CEO” as “Strategic” following on the concept of Stewardship Theory which would fall into Hilb’s Strategic Principle. However in reviewing Hilb’s New Corporate Governance theory, “Good CEO” would best fit in “Integrated” which includes “integrated and targeted selection, appraisal, compensation and development of the supervisory boards and the managing boards[259]” and would include ensuring a “Good CEO”. Similarly, “Lessons Learned” although strategic in their application, better falls into Hilb’s “Situational” Principle (External) – lessons learned more often comes from the industry environment and external to these banks. These two changes have been made.

2. By integrating HILB’s principles, several new categories emerged and were added into my analysis. For example, “Targeted Selection, Feedback and Evaluation” of the Board (Strategic Principle) and “Board Configuration and Board Roles” (Situational Principle) are key Categories in Hilb’s New Corporate Governance and are categories that support “Effective Board and Board Committees” (Control Principle) in my revised framework.

[259] Hilb, ibid, p. 10

In the end, my new Coding structure for performing Grounded Theory data analysis expanded into 22 Categories that includes my original design yet integrates Hilb's Reversed KISS Principle. The 22 categories I will be researching are listed as follows:

***Revised* "Good Corporate Governance" Categories (22) in Reversed KISS (Hilb) Format:**

- Canadian Regulatory Environment - Situational (External)
- Canadian Domestic Environment - Situational
- International Environment - Situational
- International Regulatory Environment - Situational
- Breaches of Governance - Situational
- Lessons Learned - Situational
- Subsidiary & Main Board Configuration and Roles - Situational (Internal)
- Degree of Internationalization - Situational
- Organizational Complexity - Situational
- Global Integration and Local Response - Situational
- Targeted, Diverse Board Composition - Strategic
- Critical but Constructive Culture of Trust - Strategic
- Focus on Strategy and Future of International - Strategic
- Effective Chair - Strategic
- Targeted Board Selection, Feedback and Evaluation - Integrated
- Targeted Development of the Board - Integrated
- Integrated Board, Subsidiaries and Management - Integrated
- Good CEO - Integrated
- Effective Management and Company Culture - Integrated
- Auditing & Risk Management Function of the Board - Controlled
- Controlling Functions of the Board - Controlled
- Board and Committee Effectiveness - Controlled

With this revised framework of "Categories" I re-examined my interviews and restructured my interview "codes" into these 22 categories. Comments (codes) made by my interview subjects were now attached to these categories in a new blended framework of "Good Corporate Governance" for analysis of Canada's International Banks. I was now ready to start the analysis of the data.

For the purposes of analysis and to better allow triangulation of the results by interviewee group (chairman, director, CEO, chief risk officer, Canadian banking expert, and international banking expert), I needed an analytical framework to display each category, the codes within each category, and the respondents who cited any code or category during our interviewing process. I formatted my findings into this analytical framework for each of the twenty-two categories:

"Good Governance" Category (22 in total - above):							Canadian	Foreign		Cited
			Chairman	Director	CEO	CRO	Expert	Expert	Totals:	%
	Total Interviewees:		3	3	2	2	3	2	15	
	Made comments:		0	0	0	0	0	0	0	0%
Sub-Category:										
									0	0%
									0	0%
									0	0%
									0	0%
									0	0%
		Total:	0	0	0	0	0	0	0	0%
	# Citations per Source:		0.0	0.0	0.0	0.0	0.0	0.0	0.0	

As displayed above, each of the twenty-two categories contain a variety of subcategories which are also presented in this format for ease of review and analysis. Subcategories are created by grouping similar comments (codes) made by different interviewees. For example, one interviewee mentioned that his bank board has a culture of open debate. "Open debate" would be a "code". Similar comments made by other interviewees would also be coded and grouped with this one in the sub-category "Constructive Engagement". Constructive Engagement was later identified to be a sub-category of the category "Critical but Constructive Culture of Trust", within Hilb's "Strategic" Principle.

By using the above format both the researcher and the reader can quickly deduce:

1. The total number of comments ("codes") attributed to each category. This quantification provides a relative importance that a category or sub-category plays in this research (see: "Totals" and "% cited" in above chart)[260];

[260] Note: % Cited = the number of citations divided by the number interviewees who comment in that Category

2. Which groups (chairs, executives or experts) are more or less interested in a particular category of sub-category, as viewed in the above chart under the column "Made comments";
3. By examining and comparing how each group commented on a particular category or subcategory relative to other categories will provide insight on the relative importance of each category in general how its importance to each groups (see: "# citations per source"); and
4. The biases and preferences by any group through triangulating and corroborating across interviewee groups for further insight.

Based on this structure and approach, let me now present my analysis and my initial findings of this research.

3.5.1 Keep it Situational

3.5.1.1 External Context

1. "Canada's Regulatory Environment" - Matters:

We have a good banking system here, regulated capital and a different kind of mortgage business, plus a different law structure. That let us sail through.
- Bank Chairman

In examining the first category, Canada's Regulatory Environment, we see that thirteen of fifteen interviewees highlighted some element of Canada's regulatory environment as being important to their success in achieving good corporate governance Further we see that the thirteen respondents made an average of 3.5 comments during their interview to that effect. While great mention was made on Canada's higher capital requirements and Canada's conservative mortgage system, the data obtained by these interviews indicates that while these criteria played a positive role in their success in governance, we can see that the interviewees placed even greater emphasis on the active role that the regulator played in achieving good governance. Comments included:

> **"We have high levels of trust between the banks and the regulatory authorities, something that did not exist in the United States."** – Bank Director

"We have a strong regulator, who is sort of the third set of eyes because they are into everything. While they govern by a set of rules, they are also flexible and are willing to have open discussions, although they are getting tougher" – Bank Executive

"I must give credit to the Canadian regulator, they were right to force the Canadian banks to articulate their Risk Appetite because too many people were not defining what their tolerance was for risk." – Bank Chairman

"Julie Dickson [head of OSFI] will look at it (a situation) and will say "no, you can't live with that". So we have to raise capital. The Black Swan does happen." – Bank Chairman

Category 1 - Canada's Regulatory Environment:

Canadian Regulatory Environment					Canadian	Foreign		Cited
	Chairman	Director	CEO	CRO	Expert	Expert	Totals:	%
Total Interviewees:	3	3	2	2	3	2	15	
Made comments:	3	3	2	0	3	2	13	87%
Sub-Category:								
Higher Capital/Basil Rules	1	2			3	1	7	54%
Mortgage & other Laws	3	2	1			1	7	54%
Regulator Meetings/Relations	3	4	1		4	3	15	115%
Regulation and Pressures	3	4	1		2	2	12	92%
Total Bank Focus	1				1		2	15%
Deficiencies in Canada		1			1		2	15%
Total:	11	13	3	0	11	7	45	346%
# Citations per Source:	3.7	4.3	1.5		3.7	3.5	3.5	

We note that the category Canada's Regulatory Environment was held to be in highest regard by the members of the board. Board directors and chairs cited Canada's Regulatory Environment 4.3 and 3.7 times on average respectively in their interviews. All bank directors and all board chairmen made comments. Experts were the next most prolific group to make comments on the importance of this category to generating good corporate governance across Canada's banks. Canadian and international experts commented 3.7 and 3.5 times on average respectively.

What is interesting to note is that bank executives, both the CEOs (1.5 citations) and chief risk officers (0.0 citations) did not attribute their success to the regulatory environment. Though no reason was provided in my interviews to explain this finding, I can theorize that an effective regulatory environment must in fact contribute to good corporate governance and we might infer that board directors and banking experts take a holistic view of the industry and attribute some of this success to an effective regulator and regulatory regime. However, bank CEOs and CROs are heavily involved with the day-to-day operations of their specific banks and when asked what contributes to good governance we observe that their attention immediately turns to operational matters and processes within their individual banks. As management of these banks, they focus on their own efforts to generate good governance results rather than the regulatory regime they operate within. In fact management may well see regulations as inhibitors to their real work whereas directors and industry experts see regulation as keys to success.

The subcategories Regulatory Meetings/Relations (cited 1.1 times per interviewee) and Regulation and Pressure from the regulator (cited .9 times per interviewee) received the most number of comments. This is important.

Conclusions from this category include regulation itself is important for good governance. In Canada that includes Canada's higher capital rates and Canada's mortgage systems among other things. More importantly however, board chairs and directors felt that the direct relationship they had with the regulator and the active involvement (e.g. discussions, reviews, etc.) of the regulator with their banks was the single most critical and positive initiative for these banks from a regulatory perspective. It is this effort and relationship that is singled out as contributing to making their bank (and the Canadian banking industry as a group) effective in achieving good corporate governance. This is evidenced in the above quotes referring to the Regulator pressing on banks to create Risk Appetite models in each bank and the direct reference to the regulator by name in disagreeing with a particular proposal and insisting on increased capital in that bank. That targeted and informed prodding and attention to strategic issues is seen as contributing to a healthy relationship and ultimately good governance in the banking industry.

2. "Canada's Domestic Environment" - Matters:

"The banks have had leadership positions in corporate governance for the last 20 years. The banks watch each other closely and try to adopt best practices from each other".
- Bank Director

In examining the category Canada's Domestic Environment first we notice that all 15 interviewees commented on the role that Canada's domestic environment plays in generating good corporate governance (see table 15). Notably, experts focused on the domestic environment, with 8.3 citations per Canadian expert and 4.0 citations per international expert. In this category chairs, CEOs, and experts gave the highest weighting for good corporate governance to Canada having Few, Large, and Diversified Banks, in part due to limiting foreign ownership.

Category 2 - Canada's Domestic Environment:

Canadian Domestic Environment					Canadian	Foreign		Cited
	Chairman	Director	CEO	CRO	Expert	Expert	Totals:	%
Total Interviewees:	3	3	2	2	3	2	15	
Made comments:	3	3	2	2	3	2	15	100%
Category:								
Few, Large & Diversified Banks	2	1	2	1	6	1	13	87%
Mortgage Environment	2	2	1	1	1	1	8	53%
Industry Seeks Improvements	2	1	1		3	1	8	53%
Each Bank Seeks Excellence	1	1	1		6	1	10	67%
Stakeholder & Public Pressure	1	4	1		3		9	60%
Canadian Economy	1		1	1	1	1	5	33%
Canadian & Bank Culture			1	1	5	3	10	67%
Total:	9	9	8	4	25	8	63	420%
# Citations per Source:	3.0	3.0	4.0	2.0	8.3	4.0	4.2	

Comments included:

> **"I think there are several things with our banking system – first, there are only six[261] of us in practical terms. We are six large banks, who are well capitalized, and that is very different from the US and many other countries."** – Bank Chairman
>
> **"Canadian banks are almost public institutions. Because they are few in number and they are largely public, they have always been on the forefront in Corporate Governance developments, and they have the resources."** – Canadian Expert
>
> **"I think the other thing to bear in mind is that these banks are large, diversified, coast to coast companies. They have a long and successful track record of managing big and diversified national and international companies. These are established companies. And it is taken them a long time to get it right."** – Canadian Expert

[261] While my research focuses on the "Big 5" banks in Canada who operate in every Canadian province and territory and have extensive international networks, National Bank, which is material in the province of Quebec, is the 6th largest bank in Canada and though limited internationally it is often included in discussions regarding the "largest banks in Canada".

> **"I also think that with fewer banks in Canada compared to the US, the regulators get to know them pretty well - I think they [the regulators] were probably much more on top of what was happening."** – International Expert

> **"Canada is a very young country, but we are old banks. Look around the world, even in America and certainly in Europe, you will find countries that are older than Canada, but we [Canadian banks] are older than most of the countries in Europe. We are almost 180 years old."** – Bank CEO

Canadian experts often mentioned that Canadian culture lends itself to good corporate governance. Here is a representative comment:

> **"We don't have a culture of being rampant entrepreneurial "cowboys". And we don't have the volume that the Americans and the British have. This is a broad generalization but we are probably more conservative and tempered in our views regarding complex products and risks."** – Canadian Expert

Consistent with the cultural comments referenced above, several comments supported the subcategories: Industry Seeks Improvement; Each Bank Seeks Excellence; and Stakeholder and Public Pressure. Cumulatively these observations present numerous references that the public sector, the industry, and the banks are together self-driven toward good governance (in addition to any effort from the Regulator's office) which supports the expert's observations on bank culture in Canada as a driving force for good governance. Comments in these subcategories include:

> **"The Canadian Coalition for Good Governance[262] went to OSFI with a proposal to move to majority voting, as opposed to plurality voting and (OSFI) agreed. So we sent a letter to the five board chairs and we got five "yes's" back within two weeks."** – Board Director

> **"For the last 10 to 15 years, arguably governance in Canadian banks is ahead of most if not all of the other major jurisdictions. There have been a series of ongoing incremental improvements that have added to excellence in governance. Some of that was self-driven, some was driven by institutional investors and the governance community, like the CCGG [Canadian Coalition for Good Governance], some of it was driven by regulators and some of it was driven by a cadre of people who**

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[262] For more information on the history and background of Canadian Coalition for Good Governance see: Section 2.1.3

believed that it was the right thing to do to add value to have continuous improvements. – Board Director

"I think that Corporate Governance became an area that everyone began to be interested in - not only banks and regulators, but also people in Canada that were relatively influential. Here I am referring to the Dey Report [1994][263]. (That led to) the movement to get independent directors on the boards. (Next it was) the separation between Chair and CEO. I think these changes were important – they created a good foundation for (Canadian Bank) Boards. – Canadian Expert

"The banks have had leadership positions in corporate governance for the last 20 years. The banks watch each other closely and try to adopt best practices from each other." – Board Director

The key conclusion of this category is that having Few but Large National Banks that regulators get to know well is of critical importance. Combined with a bank's culture, stakeholders that Seek Excellence and banks that are competitive with each other, collectively these domestic environmental factors contribute positively to Canada's banks achieving good corporate governance. References were also made to the strength of Canada's economy as well as Canada's sensible mortgage framework; however Few but Large National Banks is critical for success in these banks achieving good governance.

1. The "International Environment" - Matters:

"Canada is roughly twice as expensive as the US. That is partly due to the size of the market. Secondly you don't have competitors who consistently come up with cheaper and more innovative offerings - they are very effective and really, really very tough competitors."
- International Expert

The category "International Environment" was ranked the lowest of the 22 categories I examined. Only 11 of 15 respondents (73%) made a comment and at 23 comments in total this is the least referenced category in my research. However three interesting observations emerge:

1. Although only 1 international expert chose to mention the importance of the international environment to international success, he emphatically stressed

[263] Ibid

the challenges international expansion can play on banks.

I believe that they (the Canadian banks) are not used to the brutal competition that occurs in the United States. Canada is a bit of a "kinder market" to compete in. People there (in Canada) are not as ruthless.” - International Banking Expert

2. The majority of comments made in this category related to “Optimizing Subsidiary Boards”. Again although we see a lower response relative to other categories, respondents generally recognize the need for subsidiary boards to functioning well and to be optimized for effective performance.

“But you know (a subsidiary) has been a source of a reasonable amount of losses and in context of governance the Board (of that subsidiary) did not actually have enough transparency to understand what it (the problem) was.” – Bank Chief Risk Officer

3. Lastly within the “International Environment” are the sub-categories “International Differences” and “Harmonization and Complexity”. Comments were received in 4 Groups. If examined as a single sub-category, they reflect the recognition that environmental differences exist between the home market and the international market that brings additional complexity to the company.

“I guess the biggest issue as I see it is the different regulatory environments that are creating a great deal of complexity - that is probably the biggest issue. From our perspective I think we try to keep it so that we are never going to have anything (occurring in our international subsidiaries) that is not too inconsistent from (what we do in) the mother ship.” – Bank Chief Risk Officer

Category 3 - Canada’s International Environment:

International Environment:					Canadian	Foreign		Cited
	Chairman	Director	CEO	CRO	Expert	Expert	Totals:	%
Total Interviewees:	3	3	2	2	3	2	15	
Made comments:	2	2	2	1	3	1	11	73%
Category:								
Optimizing Subsidiary Boards	2	2		1	1		6	55%
Harmonization & Complexity		2	1		1	1	5	45%
International Banking Crisis			1		2	1	4	36%
International Best Practices			1		1	1	3	27%
International Differences			1	1	1	2	5	45%
Total:	2	4	4	2	6	5	23	209%
# Citations per Source:	1.0	2.0	2.0	2.0	2.0	5.0	2.1	

In spite of the low ranking several key observations come from this category. From a research perspective, a low number may be viewed as an outlier in statistical terms. However in qualitative research, outliers can often provide important insights. Since the thirteen Canadian respondents did not place much emphasis in this category, it gives attention to the expert located outside of Canada who may have somewhat better insight to the challenges Canadian banks face in their strategies as they expand and operate internationally. Secondly, when it comes to optimizing subsidiary boards, respondents indicated that they take into consideration realities in their subsidiary makeup. These considerations directly reflect the theories we examined earlier, including: Hilb's degree of internationalization (figure 6), Hilb's degree of freedom (figure 7), and Kiel's governance options for international subsidiaries (figure 8) to empower and structure subsidiary boards taking these theories into direct consideration. This observation reinforces the importance of these three theories in international banking and also allows a degree of freedom between banks in designing the optimal structures for their own international subsidiary boards. This is an important finding. These experienced international banks know that if they do not get this mix correct, problems can emerge with the subsidiary. To minimize the impact and the added complexity to the strategy and the operations of the bank emanating from this international dimension requires successful companies to seek harmonization wherever possible to increase any possibility of achieving good corporate governance both at home and in the international subsidiaries.

3. The "International Regulatory Environment" – Matters:

"The UK regulator is taking a different approach demanding more information. They are insisting on reading the board minutes, as well as the board evaluation reports. They also feel they need to sit in on board meetings." – International Expert

The category International Regulatory Environment ranked twelfth in terms of comments made by interviewees (see table 17). In examining this we first note that fourteen of fifteen respondents highlighted the international regulatory environment as playing a role in their plans to achieve good governance and success internationally. Three key observations emerge:

1. The most number of responses came from the six board members: the three board chairs and the three directors. In their interviews they referenced the

importance of the international regulatory environment an average of 4.7 and 4.0 times respectively. Comments included:

“I worry that after the banking crisis the world's financial community is trying to find a "one-size-fits-all" set of rules and regulations. Not everybody is the same. Our international focus has us in 50 countries. The Basel rules have capital charges that seem to penalize us and our (international) strategy.” – Bank Chairman

“A peculiarity of banking is that local regulators insist you have a local board responsible for the operations of that country. So if you go to the United States, the Federal Reserve Board, the OCC (Office of the Controller of the Currency), or the FDIC will all insist that the US board has accountability for US risk. That complicates it all (for us), because (the main Board) also needs to have oversight. If it wasn't for those (international) rules we would just have it all roll up (to the Main Board).” – Bank Director

“What happens in Europe is they are half as well capitalized as we are, even though they have the same rules. The last thing Germany wants to see is Deutsche Bank go down. So they look the other way and don’t apply the rules as stringently as OSFI does. For instance, they accept the value of Greek bonds at par.” – Bank Director

“We now meet regularly with regulators that regulate our international subsidiaries. For example, we are meeting on Friday with the Fed from US. In July we were in England (for a main Board meeting) and met with the Financial Services Authority, about the issues tied to that jurisdiction.” – Bank Chairman

Category 4 - International Regulatory Environment:

International Regulatory Environment					Canadian	Foreign		Cited
	Chairman	Director	CEO	CRO	Expert	Expert	Totals:	%
Total Interviewees:	3	3	2	2	3	2	15	
Made comments:	3	3	2	1	3	2	14	93%
Sub-Category:								
Int'l Regulation & Weaknesses	4	3	1			1	9	64%
Challenges of Integration	4	5	1	3	5	1	19	136%
Impact on Subsidiaries/Boards	1	2		2	2		7	50%
Int'l Regulatory over-reaction	2	1	1	1	2	1	8	57%
Working with Int'l Regulators	2		1		1	1	5	36%
New Global Regulation	1	1	1		2		5	36%
Total:	14	12	5	6	12	4	53	379%
# Citations per Source:	4.7	4.0	2.5	6.0	4.0	2.0	3.8	

2. The respondent who provided the highest number of citations on the importance of the International Regulatory Environment to his bank's success came from a chief risk officer. Risk officers must concern themselves with the detailed workings of the bank operations and processes to be compliant with internal regulations as well as meeting the needs of international regulators:

    "Another regulatory angle is the uncertain amount of regulatory protectionism going on, where you end up having regulators take independent action on certain things. They might get ahead of the rest or they may say "well these are the Basel regulations, but here's what we are going to do". So, we need to understand this regulatory arbitrage and the different ways we need to manage our businesses in London or New York. It can create a whole different complexion that drives behaviours." – Bank Chief Risk Officer

3. Another group that underscored the importance of the international regulatory environment were the Canadian banking experts. Their collective view provides valuable insight and triangulation on issues facing Canadian bank success, in this instance in the International Regulatory Environment::

    "I observed recently that some regulators have decided to sit in on (subsidiary) board meetings. That's been going on in Germany for a while now. The UK/FSA is saying that they will do that on occasion. Another regulator said they will as well. These are all very interesting developments." – Canadian Banking Expert

4. The subcategory Challenges of Integration received more than double (nineteen) the comments of the next most frequently mentioned subcategory. Also most of the interviewees commented specifically on the importance of this subcategory. The challenges of integration are operating priorities for management, but in this case board chairmen, board directors and the Canadian expert panel also recognized the challenges in first integrating and then staying current with international regulation especially when spread across numerous jurisdictions: One comment included:

    "We recognize that each of those subsidiaries has to comply with the regulatory requirements of the jurisdiction in which they operate, and that is changing. For example, it's no longer sufficient for us to manage risk in our European subsidiary or the UK from Canada. We have to have a Chief Risk Officer there, capital requirements have to be met by that particular entity, and this is true for all of our

> **subsidiaries, in the US as well, and so forth. It's become much tighter than it used to be."** - Bank Chairman

I take several conclusions from this category. First, board members are responsible for governance and oversight and that includes staying compliant with the regulations in effect in each jurisdiction. It is understandable that board members would be particularly attuned to the impact that international regulations would have on their bank and the success of their international subsidiaries. It is obvious that these Canadian directors are diligent in trying to stay current on the international regulatory needs of their subsidiaries. These directors are also aware that international regulators can apply regulations differently in their jurisdiction and that these differences from Canada's home market can create regulatory arbitrage and competitive differences for international banks. This view was also endorsed by the chief risk officer from his perspective of managing risk. These differences become even more important for banks that operate a broader and more diversified network of international subsidiaries.

The above quotes lead me to conclude that Canada's banks are quite familiar with international regulations and work hard at staying current with international regulations as they change and as their international businesses evolve. They are also quite aware of the importance in staying compliant with international regulation in order to achieve their goal of good governance. Lastly, they also are aware that regulators take different views on regulations and these variations, particularly as it affects capital, does create for regulatory arbitrage across jurisdictions.

5. "Breaches of Governance" – Matters:

"We have all had breaches, mainly in trading or brokerage areas." - Bank Chair

"You know when you look at these things in hindsight, you see that they tend to be breakdowns in controls that could have been prevented." - Canadian Expert

This category ranked 10th highest of the 22 categories with 57 citations. I was pleasantly surprised by the openness of the responses as well as how these events still resonate within each bank, though some go back over a decade. Although "breaches" are a blemish on the banks' reputations, respondents spoke of them openly as though they were historic events that helped their development and strengthened and matured these banks. Every bank has had some form of operational breach ranging from something as small as an employee exceeding a particular limit[264] through to an $800 million trading fraud at Bank of Montreal's subsidiary in New York, mentioned earlier. Breaches of governance and the next category "Lessons Learned" serve as important building blocks for development and communication for these banks to achieve their goal of "good governance". This was a very active area of discussion among my interviewees.

Category 5 - Breaches of Governance

Breaches of Governance:	Chairman	Director	CEO	CRO	Canadian Expert	Foreign Expert	Totals:	Cited %
Total Interviewees:	**3**	**3**	**2**	**2**	**3**	**2**	15	
Made comments:	**3**	**3**	**2**	**2**	**3**	**1**	**14**	93%
Sub-Category:								
Breakdown / fraud in "Big 5"	3	7	3	2	1	1	17	121%
Board / Management failure	2	6	2		3	1	14	100%
Reaction to breakdown	2	1		1		1	5	36%
Reason for breakdown	2	2	2	2	2		10	71%
Breaches in other companies	2	2	2	2	2	1	11	79%
Total:	11	18	9	7	8	4	57	407%
# Citations per Source:	3.7	6.0	4.5	3.5	2.7	4.0	4.1	

Several important observations emerge in analyzing this category:

1. Board members (Chairs and Directors) commented the most about breaches with an average of 3.7 citations and 6.0 citations respectively during their interviews.

> **"We had some write-downs that came off the subprime hit. The lesson learned is that it's not always sufficient just to have an open and transparent relationship with senior management, because even senior management sometimes fails to be in total control of what's going on down on the trading floor."** – Bank Chairman
>
> **"We had a rogue trader in the UK, who blew $100 million, and falsified documents. He just kept getting deeper and deeper and we finally caught him."** – Board Director
>
> **I think the board made that decision without full information. I don't think the board knew what management was doing - that Management had taken the hedges**

[264] Banks have numerous "Limits" for individual and business units. These include signing authority limits, trading limits and lending limits. Breaching a limit was usually incidental having little to no material financial consequence.

off their equity investments. And I don't think a board would endorse that if they knew the full story. I think management were trying to "shoot for the fences" and they shouldn't have done that. Could that happen at our bank? It would be much harder to do but I'll never say "never"." – Board Director

2. The sub-Category "Breakdown / Fraud in "Big 5" received the most citations with 17 comments:

 "We have all had breaches, mainly in the trading or brokerage areas. Have we had breaches or problems that have gone on and on for a long period of time? No, generally the checks and balances are there and I think that has kept things to a minimum but we have all had them (breaches)." – Bank Chairman

3. Executives, both CEO's and CRO's, were also very active in this category, with 4.5 and 3.5 citations each respectively. This executive openness and interest in understanding and discussing breaches of governance in their bank reinforces the comments we heard earlier about banks in Canada having a strong competitive desire to be leaders in corporate governance. It would appear that these executives take these negative events personally and work hard to avoid them in future by discussing them openly, as examples to all employees in their banks that bad things can happen and as a reminder that Management must remain ever vigilant.

 "What we all fear is you get a UBS event, where the guy was doing all of the right things, but there's a $2 billion fraud. The CEO is now gone and that CEO had come to UBS because he was a great manager at another bank. But you can't stop fraud. You can mitigate it and lessen the impact, but you can't stop it." – Bank CEO

 "The breach I would mention is a London mispricing incident. That incident identified gaps in governance in areas of internal controls in that process. The response was the board saying they want this resolved. It started by going to see the regulator." – Bank CRO

What is particularly interesting is that in addressing this category, experts squarely pointed the finger of responsibility (blame) at management and the board. However executives and board chairs are less critical of themselves by saying that bad things happen. Experts say that the board or management is defective. Management says you cannot stop mistakes or bad people who are intent on doing bad things. Very different perspectives as evidenced in these two comments:

> **You know we have had our own troubles. We had a rogue trader in the commodities business and we lost a big number. He was fixing the books. So we had a rogue trader and we missed it. These things happen.** – Bank Chairman

> **I contest the word "rogue" that somehow it's a bad apple. It is a person operating within a culture - within the internal controls. The assumption is that the culture was appropriate and that the internal controls were appropriate and this was just a "bad person". This may be a bad person. But where is organizational and governance responsibility – which is "tone at the top" and internal controls. It's about being able to say "if we had the right controls in place would this have happened". Should individual directors understand this?** – Canadian Expert.

Several interesting conclusions emerge. First we note that bank insiders deflect blame from management and the board preferring to blame a rogue individual. Critics on the other hand place full blame on management and the board for any defect that occurs within these banks. Secondly, though painful and costly, these breaches allow banks to institute even better procedures and processes. They use these historic events as examples of what must be prevented in future. Lastly, these banks in Canada are keenly competitive with each other. Since there are only five national banks, every Canadian citizen knows them. A breach of governance is usually a reportable event and makes national media headlines. With so few banks in Canada, every Canadian hears about any misfortunes, so every bank carefully guards against being the one whose reputation is being blemished by the Canadian Press.

6. "Lessons Learned" – Matters:

"That was one of our "lessons learned". We learned never to open an international office without a (one of our own people) running it." - Bank Executive

As a compliment to Breaches of Governance, "Lessons Learned" plays an integral role in evolving and developing governance processes and practices in these banks. What is particularly of interest here is that the Lessons Learned are often from other banks which is why I have associated Breaches of Governance and Lessons Learned in the *External* dimension of Hilb's Situational framework.

Category 6 - Lessons Learned:

Lessons Learned					Canadian	Foreign		Cited
	Chairman	Director	CEO	CRO	Expert	Expert	Totals:	%
Total Interviewees:	**3**	**3**	**2**	**2**	**3**	**2**	15	
Made comments:	**3**	**3**	**1**	**2**	**2**	**1**	12	80%
Sub-Category:								
Brought in Outside Consultant	3						3	25%
Recognized "Gaps"	2	3	1	4	1	1	12	100%
Changed Control Processes	4	6		3			13	108%
Review other banks / Lessons		3	1			1	5	42%
Changed Governance Processe	4			4	2		10	83%
Total:	13	12	2	11	3	2	43	358%
# Citations per Source:	4.3	4.0	2.0	5.5	1.5	2.0	3.6	

What is interesting to note is that this category was most discussed by chief risk officers, the executives charged with the responsibility for mitigating risk and looking for continual improvements in their banks governance and operating practices. Also we can speculate that when breaches occur, they are seen as an industry event that every risk officer examines to see if this crisis could occur in their own bank. It is a reactive rather than strategic process. In practical terms the board of directors will ask each Risk Officer at their next encounter: "Can that happen here?"

> **"I think the lesson learned was we needed to understand why it happened and analyze how it happened. We said let's back up and understand why was that possible - what were the underlying themes that permitted something like that to happen. And what we wanted to do is we wanted to transform the organization so that won't happen again – so it's sustainable."** – Chief Risk Officer

> **"One lesson learned is that the first time someone shows up on your radar screen you should either fire the person or go really hard on them! The people who eventually get fired, usually have given a number of warning signals earlier. It's actually quite interesting. The lesson is there's no point in being too forgiving."** - Chief Risk Officer

> **"But if there was anything we could do over again it's that we probably went out of our way to have open conversations to figure out what's the right thing to do and how to do it. After a few years they told us that it would have been helpful if we just mandated certain things."** – Chief Risk Officer

> **"I think there is a tendency to underestimate the cost of management time and the challenges of establishing a new subsidiary or an international affiliate. The business**

> **initiator will say: "If we just do it this way, we'll get this type of revenue", without recognizing the overflow effects of everything else you then have to do - the 150 things you have to do to make this thing work."** – Chief Risk Officer

Lessons Learned are clearly of importance to the board. Chairs and directors mentioned this category in their interviews 4.3 and 4.0 times on average respectively. With the board's responsibility for oversight and governance, directors may be less familiar with some detailed banking process than the executives themselves. As a result directors may have more difficulty to predict where in banking operations things may go wrong. However, when the media reports a bank crisis, bank directors not only have an obligation but also a case to reference to ensure that this particular crisis could not happen in their bank. The concept of Lessons Learned becomes very real for all directors and adds to director development.

> **"I think the other lesson learned is that it's important to spend a good deal of time examining governance issues that are coming from other banks around the world. I do that and it does take a good deal of my time. For example I've read the Soc. Gen. Report. And it's not just financial sector issues. You look for what went wrong, could that happen here and what are the lessons learned."** – Board Director

> **"I think it is really interesting in the study of governance that even great corporations that have lasted extended periods of time will reveal that they have made mistakes. The issue in part is how do you deal with them when they happen? And how do you learn from them? And how do you not do that again?"** – Board Director

> **"With that (breach), we took a thorough review of our risk management – we brought in McKinsey who did a thorough study - we upgraded the people; we upgraded our systems; and I think to some extent it has put us in a pretty good stead."** – Board Chairman

> **"There is one other lesson learned. In one of our subsidiaries we realized we didn't have senior enough executives locally. So we went out to hire top-notch executives in Risk and in the control functions. It cost us a lot of money as we hired a lot more people and we elevated the job specs."** – Board Director

Again we note that the expert panel had less to say about Lessons Learned in great part as they would be less informed about that the details of lessons learned by Canadian banks other than through the concept of governance renewal and industry development.

Lastly, it should also be noted that the subcategories that received the majority of commentary were Recognized Gaps and Changed Control Processes implying there is an active analytical review process after a breach in the industry or internally, that is followed by change within their bank at the conclusion of their analysis. This trend is not dissimilar to how regulators react with they see a major fraud. In industry, breaches are followed by new regulations. Inside banks, breaches are followed by new procedures and processes.

We can conclude in these two categories that the Canadian banks actively seek improvement and use Breaches of Governance and Lessons Learned as an opportunity for improvement. The degree of interest they express in Lessons Learned underscores the desire these banks truly have to achieve good governance.

We now turn our attention to the *Internal* Context, of Hilb's Situational framework.

3.5.1.2 Internal Context

7. "Subsidiary and Main Board Configuration and Roles" – Matters:

"One main Board Director sits on the US board and Chairs the Audit Committee. Another Director is on our other US subsidiary Board. We have Management on that subsidiary Board as well. Our CEO sits on all three boards." - Bank Executive

This category ranked fifteenth out of the twenty-two categories. It addresses the configuration and roles of the main and subsidiary boards (see table 20). Several interesting observations can be identified. The board chairs commented the most in this category. Only one of the directors spoke to this category but that individual serves as chair in another corporation. I theorize that as the lead director on the board, it is the chair who focuses the most on the effectiveness of the board and would consciously be examining the makeup of the main board and the subsidiary boards. This would include examining the optimal board size, the board's skills matrix, the configuration of the boards and the roles each director plays.

Category 7 - Subsidiary Board and Main Board Configuration & Roles:

Subsidiary & Main Board Configuration & Roles					Canadian	Foreign		Cited
	Chairman	Director	CEO	CRO	Expert	Expert	Totals:	%
Total Interviewees:	**3**	**3**	**2**	**2**	**3**	**2**	15	
Made comments:	**3**	**1**	**2**	**2**	**1**	**2**	11	73%
Sub-Category:								
Main Board Structure & Skills	5	1	3		1		10	91%
Directors on Subsidiary Boards	3			2			5	45%
Management on Sub Boards	1		1	2			4	36%
Local Directors / Advisors	1	1		2	1	1	6	55%
Board Size Matters	2	2	3		1	1	9	82%
Issues / Difficulties	2			2		2	6	55%
Regulator Impact	1		1			1	3	27%
Total:	15	4	8	8	3	5	43	391%
# Citations per Source:	5.0	4.0	4.0	4.0	3.0	2.5	3.9	

While board chairs may all share this responsibility, their views differ on how boards and subsidiary boards should be configured and the roles directors should play, as seen in these following comments:

> **"I think you are onto a very interesting study. I think that anyone who tells you that the subsidiary board takes care of it (governance) is crazy. It's window dressing. Now if you asked our CEO, he wants that outside board as it represents the community but these are management reasons and not governance reasons. He might argue it from a governance point of view but I could find five other managers who would tell you that they wished it [the subsidiary board] wasn't there because it takes so much time and they know that ultimately that we [the Canadian board] are responsible."** – Bank Chairman

> **"Many years ago we had a main board director residing in London who also served as chairman of our UK and European main subsidiaries. I must say I am not a fan of that model. I prefer senior management playing that role reporting to the board. You shouldn't have one board member who has a role above and beyond with respect to his specific business. I don't think that is effective governance. In general I am not a fan of main board directors sitting on subsidiary boards."** – Bank Chairman

> **"We said: "look, we cannot keep on top of all the governance processes by having everything come up to this board, we need to have a filter, and we need to have that for regulatory purposes too. Let's go out and build a stronger risk organization,**

> **audit organization, H.R. function and beef up all the control functions in the US, reporting to a stronger US board with Directors who know the issues and the rules". These are wholly-owned subsidiaries so we weren't worried that the Directors would be cowboys who go off and do their own thing."** – Bank Director

> **"We have a separate board in the US. I sit on that board not because I am Chairman but because we said we should have one representative from the board in Canada on the US board and I volunteered. That was before I became Chair." –** Bank Chairman

Although two of the Canadian experts did not refer to this category, the international experts did. I believe that their background and experience in international banking gives them a unique insight to the importance of coordinating efforts between the subsidiary and the main board as evidenced in these comments:

> **"Your question is about the relationship between Subsidiaries and HQ. I think that's an area that requires further development. In some businesses, there is a kind of hub in HQ with spokes which makes it highly centralized. There is resistance to the idea that anyone local, even an outside director, has anything to contribute or has the capacity to say "no" don't do it. Thank God we <u>did</u> have people (subsidiary directors) who said "no" don't do subprime mortgages here in Europe. We saved a huge amount of money as a consequence. However, the board in New York didn't save that money!"** – International Expert

> **"Well a lot of institutions now have advisory boards in their foreign operations. There's nothing wrong with these advisory boards in the sense of getting input in terms of understanding what's going on. But the people who serve on those advisory boards don't view themselves as being accountable to the shareholders of the bank or accountable to the regulator in home country. I think they are quite useful but they are useful at information gathering and not as a governance mechanism." –** International Expert

While executives had a lot to say about this category, it's interesting to note that the chief risk officers were most interested in the makeup and the operations of the subsidiary boards and committees, while the CEOs were more focused on the configuration and the size of the boards:

> **I think as the business grows into a large international business having a regional governance structure will be important. But depending on how you are set up it may**

or may not blend well with the legal entity structure – for example, currently in the US we have a US Corporate Governance committee which I chair for historical reasons. That has worked OK. But then I move to the US holding company where we have a different board and have a separate meeting of the US corporate governance committee to deal with the businesses that are outside the other US legal entities. We try to work it to feel like one meeting but in fact it is two meetings – it's a bit awkward. – Chief Risk Officer

"The Chair of our Audit Committee sits on the US board and is chairman of the Audit Committee there as well. Our US resident Board Director is also on the US Board. We have some Management who sit on the US Board and of course our CEO sits on all three boards. There is going to be a little more cross-pollination but that's where we are today." – Chief Risk Officer

"The first thing is the Subsidiary Board guidelines that we use - very management oriented, very strategic guidelines. Secondly we work very closely with the local regulators. We do in every case. We have parallel (Board and Management) structures that we have in Canada. It all exists there in parallel. We have an auditor there, a CFO there, and very importantly every one of those jurisdictions has a jurisdictional head who has the ultimate authority locally." – Bank CEO

The conclusions we can generate from these observations is that the members of the board are strategic in their approach to the configuration and roles of the main and subsidiary boards. The executives on the other hand are more tactical in their approach. The experts appear to be more theoretical in their views. These different perspectives add valuable insight to the attributes needed to create an effective and holistic configuration and relationship between the main board and subsidiary boards in these banks.

I also conclude that these banks do not share a common view on the best way to approach subsidiary board configuration and roles. They all have good governance, but each bank seems to be taking a unique approach to this goal. As discussed earlier with Kriger, Gillies, Kiel and Du, there are numerous situational variables that come into play in creating the optimum configuration for the main board and each individual subsidiary board. These banks confirm the findings of these prior studies. These Canadian banks create solutions for their subsidiaries based on the internal context of their bank and the external and regulatory context affecting their subsidiaries.

8. "Degree of Internationalization" – Matters:

"They are absolutely critical. Our strategy includes a fourth business line which we call the "International Bank" for the 35-50 countries we operate in." - Bank CEO

Analysis of this category reveals several key points (see table 21). First, 40 percent (six) of interviewees did not reference the Degree of Internationalization as a critical component in the governance of international subsidiaries and as a result this category ranked low at number twenty-one of the twenty-two categories and obtaining only thirty citations.

Category 8 - Degree of Internationalization:

Degree of Internationalization	Chairman	Director	CEO	CRO	Canadian Expert	Foreign Expert	Totals:	Cited %
Total Interviewees:	**3**	**3**	**2**	**2**	**3**	**2**	15	
Made comments:	**2**	**1**	**1**	**2**	**1**	**2**	9	60%
Category:								
International strategy	2	1	2	2	1	1	9	100%
Control of Subsidiaries	2	2	1	1	2	1	9	100%
Hierarchy of Subsidiaries	3	1	1	1		1	7	78%
Structure of Subsidiary Board	2	1		1		1	5	56%
Total:	9	5	4	5	3	4	30	333%
# Citations per Source:	4.5	5.0	4.0	2.5	3.0	2.0	3.3	

However it is interesting to note that every chief risk officer and international expert did comment about the degree of internationalization, perhaps for differing reasons. Earlier I theorized that international experts have an increased awareness of the complexities inherent in international environments that banks must address (inferring that a competency in internationalization is beneficial for international strategies of banks). Alternatively, chief risk officers focus on the importance of international experience and expertise to reduce the inherent risks and to run their operations smoothly. These views are expressed in the following comments:

> **"I think the Canadian banks have in degree been fortunate like the Australian banks for not extending themselves around the globe as some of the British banks and some of the American banks chose to do. And when things went badly wrong globally, their exposure was actually less than the big American or UK banks."** – International Expert.

> **"Over the next 10 years we can predict that more (business) will be from overseas, outside of Canada. As those areas of the world become more important for revenues and earnings, it becomes increasingly critical that the people who sit on those international boards really start to integrate their functions with people from the central board. But I would say that this is really easier said than done."** – International Expert.

> **"We have got a fair bit of international structure. Fundamentally if you look at it from a Risk standpoint we run the vast majority of our significant risks through the (main) Bank. Then you have (3 named business lines) and they all have a number of subsidiaries (to meet their unique business strategies).** – Chief Risk Officer

But the most significant observations were provided by board chairs and directors who both stressed the importance that the Degree of Internationalization plays in effecting good corporate governance in their international subsidiaries. Examples included:

> **"The more far flung the Empire becomes, the challenge to have the same level of management control and awareness in different parts of the world increases. We have found over time that unless you give an extra amount of scrutiny to international areas that are material to the bank there is a higher risk of them running afoul."** – Bank Chairman

> **"It's a big world out there and it's tough to find places to go in Canada that would be fine or we would be allowed to go in Canada, so I think we will become increasingly more internationally focused. So, how will we control the international Boards? It will become a greater and greater issue. We are going to have to read your thesis to find out how we do that!"** – Bank Chairman

Two subcategories received the vast majority of attention from all interviewees in this category. The importance of having an International Strategy was stressed in receiving nine citations:

> **"Well (our international strategy is) very important. As far as our future is concerned, we have just invested billions (in foreign acquisitions). We are not quite where TD is with more branches in the US as in Canada, but we are getting close. It's 60 - 40 or something like that. So, it's pretty significant." – Chairman**

Also in this category, the subcategory that focused on the Control of Subsidiaries was also cited nine times:

> **"Well actually we think you need to be organized in a fashion where you are less complex from an organizational structure standpoint, where you have fewer international subsidiaries, you have got better ability for the flow of funds from point A to point B, and then you have liquidity and tax things – we want a more simplified structure."** – Chief Risk Officer

I conclude that although all of these banks are active internationally and several for more than a century, some are more experienced internationally than others. That is important because each of these banks recognize that the Degree of Internationalization plays a significant role in how they configure their main board and subsidiary boards as well as in crafting their international strategies for the future. These strategies will in turn also drive changes to the main board and their subsidiary boards. This will explored further later in this study.

9. "Organizational Complexity" – Matters:

"We have to realize that in these global banks, their operations are complex. You just can't show up every other month for a day or a day and a half at a board meeting. It's really pretty hard to understand the full scope of their activities." - International Banking Expert

The category Organizational Complexity ranked in the lower half of the categories, ranking eighteenth out of twenty-two and only receiving thirty-six comments from the interviewees. What stands out in this category is the emphasis the bank executives placed in organizational complexity when it comes to seeking effective governance. This category with an average of 5.5 citations for the two chief risk officers on average and 5.0 citations for the one CEO who commented shows that the focus of the Executive Group is more heavily geared toward the day-to-day activities of the banks. Executives would be more intimately aware of the organizational complexity in their banks and would spend more time seeking to oversee and manage this complexity. These respondents made particular reference to the subcategories: Complex Matrix Organizations, International Complexity, and Business and Product Complexity that they have to control. Risk, for example, has dual reporting lines in all of the banks, which highlights the complexity of matrix organizations while both the CEOs and the CROs would aware of the added complexities in their banks brought on by their international operations as well as their broad product and business structures.

This awareness is important in targeting good governance and operating effectiveness in these banks.

Category 9 - Organizational Complexity :

Organizational Complexity						Canadian	Foreign		Cited
		Chairman	**Director**	**CEO**	**CRO**	**Expert**	**Expert**	**Totals:**	**%**
	Total Interviewees:	**3**	**3**	**2**	**2**	**3**	**2**	15	
	Made comments:	**3**	**2**	**1**	**2**	**3**	**1**	12	80%
Category:									
Complex / matrix organizations		1	1		4	1		7	58%
Complex Board Expertise		1		1	1	1	1	5	42%
Complexity of Controls		1			2	1		4	33%
International Complexity		3	1	1	2			7	58%
Regulatory complexity		2	1	1		1		5	42%
Business/Product Complexity		1	1	2	2	1	1	8	67%
	Total:	9	4	5	11	5	2	36	300%
	# Citations per Source:	3.0	2.0	5.0	5.5	1.7	2.0	3.0	

Organizational complexity comes from both the issues of establishing and operating in a foreign location as well as in dealing with additional foreign regulators in the subsidiary's jurisdiction. These thoughts are revealed in the following comments:

> **I think there is a tendency to underestimate the cost of management time and the challenges of establishing a new subsidiary or an international affiliate. The business initiator will say: "If we just do it this way, we'll get this type of revenue", without recognizing the effects of everything else you have to do - the 150 things you have to do to make this thing work.** – Chief Risk Officer

> **"They (regulators) are getting into risk and compensation where I agree a lot has to be done. Those principles have value: deferment of bonuses; tail end risk; and all that stuff. But (internally in our bank) the compensation program for wealth management for example, is different from investment bankers and the retail bankers in Canada. And then if you look at our bank, we are in 50 countries with multiple products. The countries are different with their tax rules as well as regulations [that affect compensation]. Then the FSB comes out with this proposal that "one-size-fits-all"? Wrong."** – Bank CEO

Conclusions from this category are quite important. Even though it rated low in total number of comments, it was the executives who commented and were clearly aware of the complexities in their organizations. They were actively managing these complexities, sometimes by even adding to the complexity by introducing matrix reporting lines to achieve good governance. Organizational complexity compounds the challenges of governance, especially when you include international subsidiaries. The executives in Canada's banks understand this complexity and actively address it in their subsidiaries.

10. "Global Integration and Local Response" – Matters:

"You really do need a good blend of home country procedures with local country knowledge of risk and marketplace." - Bank Expert

"Global Integration and Local Response" (glocal) was one of several new Categories that were added to my research as a result of merging Hilb's Framework into my own "Good Governance" Framework. For this category we see a low response rate with 36 citations which ranked this Category as #17 of the 22 Categories I researched. However, what stands out in this Category is that all three board chairs interviewed recognized the importance of global effectiveness and local responsiveness. Also board chairs, directors and CEO's all emphasized the importance of two of the sub-categories:

Board chairs, directors and executives (all bank insiders) stressed the importance of "Local Effectiveness" in the host country. Comments included:

> **So the goal is to have a very few number of ex-pats. When we start in a new country, and this depends on how long we have already been there, we [send in a transition team who] instil our culture, our internal audit processes, and our compliance and technology platforms. But then over time you can edge out most of the ex-pats because you have developed good local management and have strong oversight from the parent in various [support] functions. But the parent does not run the day-to-day operations - because we are [operating] local. We are dealing with local customers and local culture - we know each country is different from every other country and so we need to develop a structure that works locally.** – Bank CEO

> **In Asia, we have an Asian advisory Council that a few of the board members go over to attend and it has local people on it.** – Bank Chairman

> **"And it's not like we say "here's the Canadian manual start going", rather we say here are our risk principles, this is how we operate - we understand it's a different environment and so we want to be a part of everything do. We want to understand."**
> – Chief Risk Officer

Category 10 - Global Integration and Local Response:

Global Integration and Local Response					Canadian	Foreign		Cited
	Chairman	Director	CEO	CRO	Expert	Expert	Totals:	%
Total Interviewees:	**3**	**3**	**2**	**2**	**3**	**2**	15	
Made comments:	**3**	**2**	**1**	**1**	**1**	**1**	9	60%
Category:								
Subsidiary Board / Controls	3		1			1	5	56%
Global Standards	1	2	1	1	1		6	67%
Local Effectiveness	3	2	2	1	1		9	100%
"Link Pins" & Glocal processes	7	1	1		1	1	11	122%
Challenges of being Glocal	2	1		1	1		5	56%
Total:	16	6	5	3	4	2	36	400%
# Citations per Source:	5.3	3.0	5.0	3.0	4.0	2.0	4.0	

This same group also referred to both Hoefstede's and Hilb's theories of having "Link Pins" and "Glocal Processes" to unite the subsidiary with the head office and main board. Comments included:

> **Also, a lot of the high potential people have been brought in from our operations outside of Canada to be "Scotia-ized", if you want to call it, for 2 to 5 years and then get sent back. So we've tried to recognize the individual cultures while at the same time trying to develop a Scotia Bank understanding and culture in each of those areas. In each of those countries we have strong local management.** – Bank Chairman

> **"One of the things we've always tried to insist upon is having a mix of people in any new international operation, some of whom come from (our bank) and carry the culture and ethics and so forth. Then we hire around them to build a team. We build that team inculcating the values and the culture of the bank. So, whether it's in London, New York or anywhere else, we have a mix of people who have grown up in the bank and can understand the bank and its culture and its approaches, and then others that we hire in. And we monitor it very carefully to make sure that the risk culture and other things are appropriate for the bank."** – Bank Chairman

> **"I continue to see placing management from (the bank) who bring the culture to our international operations and to make sure that through internal audit and regulatory compliance, and so forth, we try to assure that things are done [in the international subsidiaries] the way they would be back in Canada."** – Bank Chairman

Conclusions from this category are important. Although this category ranked low we see that it is the bank insiders clearly recognize and agree with the need for global effectiveness and local responsiveness. It is also interesting to note that the use of Linking Pins by every bank to ensure that culture, control and governance standards are all met. Contrary to my earlier observation that these banks do seem to approach their international subsidiary boards differently, they all seem untied in recognizing the need to be glocal. I also note some differing views imbedded in the above comments by board chairs. One chair stresses the importance in their bank to develop local managers while the other two stress the importance to parachute in head office employees into key roles in their international subsidiaries. Though they are opposing views, they both seem to work. By reflecting on the theories of Kriger, Gillies, Kiel, Du, and Hilb we know that numerous situational variables come into play in creating the optimum configuration and for the main board and each individual subsidiary board. These variables seem to be at play in these banks following opposing strategies yet still optimizing their governance needs in their international operations.

While this category may not have been understood by the Experts Groups to be critical, the bank insiders clearly underscored the critical role that Link Pins and glocal Processes play in their bank to achieving good corporate governance in their international subsidiaries.

I now turn my analysis to address Hilb's 2nd framework Principle: "Keep it Strategic".

3.5.2 Keep it Strategic

11. "Targeted, Diverse Board Composition" – Matters:

"I think our Board is well structured by its diversity, and I mean gender diversity, as well as diversity of experience and even ethnic diversity. Diversity leads to better thinking."
- Bank Director

Several key observations emerge from this category "Targeted, Diverse Board Composition". First, this category was rated among the highest, ranking #6 of the 22 Categories and received 64. Every interviewee commented on this category. Secondly we see that board chairs and Canadian industry experts were the groups who commented the most on the importance of a targeted and diverse board with board chairs taking a practical perspective in targeting good board discussion, and the experts taking more of a theoretical view on the benefits of diversity. Comments include:

> **"I find our board quite interesting in that they are all leaders. When you look at all of the bank boards, we have the good fortune of being able to choose the best and the brightest across the country. Being a bank board is a prestigious appointment."** – Bank Chairman

> **"Diversity is the reason – representation in the workforce and in senior levels, of women, visible minorities, people with disabilities, aboriginals. I'm not saying it's perfect. I'm not saying they have it absolutely right. But I would say our banks have made absolutely every effort to be leaders in that area. And they are recognized for that."** – Canadian Expert

> **"What you want to the extent there is disagreement is constructive engagement. I have to draw on those directors that are knowledgeable on a point so that you can hear all views. But then within a reasonable period you bring it to a conclusion."** – Bank Chairman

Category 11 - Targeted Diverse Board Composition:

Targeted, Diverse Board Composition	Chairman	Director	CEO	CRO	Canadian Expert	Foreign Expert	Totals:	Cited %
Total Interviewees:	**3**	**3**	**2**	**2**	**3**	**2**	15	
Made comments:	**3**	**3**	**2**	**2**	**3**	**2**	15	100%
Sub-Category:								
Targeted Skills & Experience	4	3	1	2	4	3	17	113%
Targeted Board Roles	4	1	2		3		10	67%
Targeted Demographics	4	3	2	1	5	2	17	113%
Conflict of Board Size & Skills	2	2	1	1	2	1	9	60%
International Skills	2	4			3	2	11	73%
Total:	16	13	6	2	17	8	64	427%
# Citations per Source:	5.3	4.3	3.0	1.0	5.7	4.0	4.3	

Further it is interesting to note that CEOs commented less than the average on board diversity and composition and chief risk officer's barley commented at all. As mentioned earlier in prior categories, this supports my theory that the bank executives seem to view the board as a single entity rather than seeing the component parts of the board. The executives seem to focus on what they can control - the detailed operations within their banks and their international networks rather than the diversity of skills residing on the Board.

I must also point out that within this category, respondents were most interested the two subcategories–Targeted Skills and Experience” was cited seventeen times:

> **“We recently brought on two people from the US, one from risk management and one from the legal community who are well-versed in banking - but we had to go to the US, because it is hard to hire a competitor’s retiree.**” – Bank Chairman

> **“If you had all subject matter people you would miss out on having people from general management who are often the most valuable directors because they've done it and seen a lot before. They bring fundamental business knowledge to the board. While they may not be particularly specialized, they've probably had CFO’s reporting to them when they were CEOs, so they understand this stuff even though they don't qualify as an audit specialist. They are wiser in many ways.”** – Bank Director

> **“Well, we have a competency matrix in the terms of the selection of them (Directors) and therefore they come from different walks of life. We do try to recruit a certain number of women, we recruit from different industries, so you don't have a bunch of financial guys or a bunch of sports guys hanging around, it's very spread. They also have different areas of interest. People sit on the Audit committee, people sit on the Human Resource committee; people sit on the Risk Management committee; people sit on the Corporate Governance committee.”** – Bank CEO

The sub-category “Targeted Demographics” was also cited 17 times:

> **“There is no perfect answer to that. We recruit directors based on diversity of experience, but most importantly, broad business experience, usually with larger complex organizations.”** – Bank Chairman

> **“I think it is managed to some extent by diversity, and I mean gender diversity, as well as diversity terms of experience and I think even maybe ethnic diversity. Now we have a lot of all of that on the board now. So diversity of input totally leads to a higher probability of diversity of observation and maybe therefore a better insurance policy against homogeneous thinking.”** – Director

Several conclusions emerge from this category. First, being ranked sixth by the interviewee group, underscores the importance that Targeted Diverse Board Composition plays in achieving good governance in these banks and in their international subsidiaries. All groups agree on the importance of diversity but they differ on several of the details. Experts press for sheer diversity at the board simply to eliminate any gaps of background and to bring additional experience, perspective, and insight to the board. Chairmen agree that diversity increases the quality of board discussion and dynamics, but they stress that diversity and board composition will not in its own create good governance and eliminate breaches in governance.

All agree that having specific skills (finance, risk, audit, governance, etc.) is fundamental, but the bank insiders were very pointed that having general management skills and prior business success also plays an important role. One expert called it, having a nose for trouble. Regardless of any difference in their views, all groups agreed that targeted, diverse board composition is critical for good corporate governance in these banks and their international subsidiaries.

12. "Critical but Constructive Culture of Trust" – Matters:

"You need an excellent relationship between the board and management; and a relationship of trust; and you need the understanding that the board is trying to bring value to the company together with management." – Board Director

Category 12 – Critical but Constructive Culture of Trust:

Critical but Constructive Culture of Trust						Canadian	Foreign		Cited
			Chairman	Director	CEO	CRO	Expert	Expert	Totals:	%
	Total Interviewees:		3	3	2	2	3	2	15	
	Made comments:		3	2	1	2	3	1	12	80%
Category:										
Constructive Engagement			6	2	1	5	3	1	18	150%
Trusting Board/Mgmt Team			5	2	5	2	2		16	133%
Make Decisions			2						2	17%
Director/Board Effectiveness			5	3	1	3	2	1	15	125%
		Total:	18	7	7	10	7	2	51	425%
# Citations per Source:			6.0	3.5	7.0	5.0	2.3	2.0	4.3	

Several key observations emanate in analyzing this Category. First we observe that all bank insiders, board chairs, directors, CEO's and CRO's recognize the importance of having a "Critical but Constructive Culture of Trust" operating at the board and between management and the board in order to achieve good corporate governance. Every chairman and chief risk officer mentioned the importance of having this culture in their boards. Comments included:

> **"Certainly what you want to have is constructive engagement. And [as Chairman], you try to draw on those directors that are knowledgeable on a point so that you can hear all of the views. But then within a reasonable period of time you have to bring it to a conclusion, and that is also part of the job of the Chairman."** – Bank Chairman

> **"I think the most important piece of governance that the directors perform is to work with management in a dialogue of mutual respect - and understanding their respective roles."** – Bank Chairman

In addition to the comments listed above, three subcategories received increased attention from the respondents. The following comments further evidence the particular importance of these three subcategories. The subcategory Constructive Engagement was cited eighteen times:

> **"Having an open discussion and having a willingness to disagree. Debating issues is important and seeking greater wisdom when we have differences [at the board]."** – Bank Chairman

> **"There are consistently varying opinions [at the Board]. And [Directors] continually champion different issues. You know when a particular director asks a question what direction he's coming from. And they hold true to their principles."** – Chief Risk Officer

The sub-category "Trusting Board" was citied 16 times:

> **"The bond between the Chair of those Board Committees and the CRO, head of HR, and the Chief Legal Counsel/CFO, should be a strong relationship."** – Bank CEO

The sub-category "Director/Board Effectiveness" was cited 15 times:

> **"I would say that the board for any significant decision is likely to ask a risk-type question of me as the chief risk officer, asking "what is your perspective on this?" – "what are the things we should worry about?" – "have you had full involvement on this?" – "what is your perspective on the decision?" They try to make sure that they have an independent risk management perspective on key issues as they are reviewing businesses or making decisions about initiatives or acquisitions."** – Chief Risk Officer

> **"The Chair of the Risk Committee once explained it to me: "We are independent contractors. It's not as if we need the money - we have nothing to lose here. If you**

> **think I'm going to do something I don't want to do, well you're wrong".** – Chief Risk Officer

Experts, both Canadian and international, spoke very little about this category. Experts, it seems, focus their attention on the diversity of the board, the separation of chair and CEO roles and other structural attributes, whereas the insiders focus more on the actual inner workings of the board, the relationship between the board and management, and the environment of openness, trust and debate that occurs within the board and the board committees.

This category ranked thirteenth out of twenty-two, based on the fifty-one total comments it received from all respondents.

I conclude that a culture of trust and openness of debate are important attributes for a successful board to achieve good governance in a bank and into their international subsidiaries, as evidenced by these bank directors and executives.

13. "Focus of Strategy and Future of International" – Matters:

"Well our international strategy is very important for our future. We just invested billions of dollars in the US. We are not quite where (another bank) is with more branches in the US than in Canada, but we are getting close. It's very significant." - Bank Chairman

Category 13 – Focus on Strategy and Future of International:

Focus of Strategy and Future of International					Canadian	Foreign		Cited
	Chairman	Director	CEO	CRO	Expert	Expert	Totals:	%
Total Interviewees:	**3**	**3**	**2**	**2**	**3**	**2**	15	
Made comments:	**3**	**3**	**2**	**2**	**3**	**2**	15	100%
Category:								
Focus on Strategy	5	6	4	3	4	2	24	160%
Importance of International	4	5	4	4	5	2	24	160%
International as diversification	4	4	3	1	4	3	19	127%
Execution of Strategy	3	1	2	4		2	12	80%
Strategic Issues	6	7	4	5	8	5	35	233%
Total:	22	23	17	17	21	14	114	760%
# Citations per Source:	7.3	7.7	8.5	8.5	7.0	7.0	7.6	

A focus on the bank's strategy and in particular its international strategies ranked near the top at number three of the twenty-two categories and receiving a total of 114 citations for an average of 7.6 comments per interviewee (see table 26). All fifteen interviewees mentioned the importance of strategy in planning the future of the bank and highlighted their international strategies. Keep It Strategic plays significant importance for all groups of interviewees; however, the bank executives (CEOs and CROs) lead the others with an average of 8.5 citations per person.

What is interesting to note is that these banks are very different from each other internationally. All five of these banks have currency and other trading operations in New York and London. This aside, the Bank of Nova Scotia (ranked second in size) is clearly recognized by the others in my interviews as being the most international of the Big 5 banks with operations in over sixty countries. Scotiabank ranks as the largest bank in Latin America and the Caribbean among all banks in the region. RBC is generally acknowledged as being the second largest bank internationally. While RBC also refers to their Caribbean banking operations and their international Wealth Management division, the other banks view RBC's international presence as being strongly geared toward Capital Markets where RBC obtains 25% of its revenue. This recently had a negative impact on RBC when in June 2012 Moody's gave RBC20 a double down grade directly as a concern over contagion stemming from the European crisis and citing their "their exposure to turmoil and potential losses in global capital markets." RBC was the only Canadian bank to be downgraded. TD Bank is seen as the third largest internationally. Outside of Canada, TD is best known for its U.S. retail banking operations, claiming to have more branches in the United States than in Canada. Bank of Montreal is fourth largest. BMO also focuses on retail banking in the United States. CIBC has a significant retail banking operations in the Caribbean, but as mentioned in one interview CIBC is the "least international'" of the Big 5 Canadian banks. These different profiles drive their unique capabilities internationally and result in very different Strategies. All fifteen interviewees stressed the importance of their international presence and strategy and the need to instill good governance practices in their subsidiaries. The four subcategories most referenced provide further insight on the importance that their international strategies play in these banks.

The sub-category "Strategic Issues" was cited 35 times:

"The more far flung the Empire becomes, the challenge will be to have the same level of management control and awareness in different parts of the world. We have found over time that unless you give an extra amount of scrutiny to international areas that are material to the bank there is a higher risk of them running afoul." – Bank Chairman

"For any bank looking at major international expansion, there are many governance issues." – Board Director

"Many boards say that their challenge is finding new board directors. And that is increasingly a challenge when so many of them [directors] have to be Canadian [per the Canadian Bank Act]. So the more countries you operate in, the more expertise you want in different markets. And that can be a challenge." – Canadian Expert

"There are also a lot of new regulations that are being discussed. There is a tremendous amount of uncertainty of it where it's going to go. The reality is everyone needs to up their game including the regulators and that's currently happening. Sometimes it's happening in clear ways and sometimes it's happening in less clear ways. The message from the regulators is that these businesses are going to be less levered, and they are going to be more highly capitalized so they are going to be lower return businesses." – Board Director

"For Management and the Board the whole area of regulatory change and regulatory uncertainty is actually a huge risk area for the board to understand in the first place. How do we manage through all of the stuff? What will the rules be? How do we manage when we don't know what the rules are or will be? This is significant." – Chief Risk Officer

The sub-category "Focus on Strategy" was cited 24 times:

"Well, (international is) very important as far as our future is concerned. We have just invested $5 billion in the US. It's pretty significant. We also have investments in China, and India, but the big one is in the US, in terms of scale at this moment. It is critical to our future." – Bank Chairman

"It's a big world out there and it's tough to find places to go in Canada that would be fine or we would be allowed to go in Canada, so I think we will become increasingly more internationally focused. So, how will we control the international Boards? It will become a greater and greater issue." – Bank Chairman

"Our bank has always believed that our strategy is important, but it is the execution of whatever strategy you choose that will determine success." – Bank CEO

The sub-category "Importance of International" was cited 24 times:

> **"The strategic importance of the international presence would vary from bank to bank. Look at Scotia, it's critical. That is their future. Look at TD. They are bigger in the US now than they are here. CIBC – they are changing a little bit - they made that US investment last year, but they are much more domestically focused. It is going to vary according to business strategy.** – Canadian Expert

> **"I have trouble separating Corporate Governance from the strategy of the bank. I think the challenge facing the bank is going to be "getting it right". That will be job number one."** – Bank Chairman

> **"And the third thing is I really do believe that as the banks in Canada really start to expand, let's assume that they have 40% of their business, say in China and Asia, well it really becomes incumbent on them to have some board meetings in China and Asia and really and to not view themselves as Canadian-centric."** – International Expert

The sub-category "International as a diversification" was cited 19 times:

> **"In the future, for purposes of risk concentration, (our bank) will need to diversify outside of Canada just strictly from a risk viewpoint."** – Bank CEO

> **"First of all, it's not necessarily a good thing to have all of your "eggs in one basket". Moving into other countries can make the bank more diversified, especially if you move into countries that have more prospects for future growth than Canada or North America in general. So I think that in the short and the long term this international presence can be quite important for future growth."** – Canadian Expert

> **"I would say that over the next 10 years probably half our growth would likely come from international opportunities. Currently about 30% of our revenues come from international, and I would expect that might rise."** – Bank Chairman

Being strategic—focusing on strategy and focusing on the international components of their business in a strategic context—is an imperative for these banks. Further, getting the governance issues right with the international subsidiaries is equally importance and strategic to these banks in their goal of achieving good corporate governance. The conclusions I draw from this category are that these banks are very strategic in their decisions regarding international expansion for the growth opportunities and the diversification that international expansion can generate for their stakeholders. They are also quite aware of the increased complexity that comes from international expansion, including increased challenges of achieving good governance. It is also important to point out that several respondents referenced the need to evolve their governance model as a direct result of the increased complexity as international expansion increased.

14. An "Effective Chair" – Matters:

"Sir David Walker said a few months ago if you have a nonexecutive chair with leadership skills and industry knowledge of those two things the more important is the leadership skills. You can't learn leadership, but you can learn banking." – Canadian Banking Expert

Category 14 – Effective Chair:

Effective Chair					**Canadian**	**Foreign**		**Cited**
	Chairman	**Director**	**CEO**	**CRO**	**Expert**	**Expert**	**Totals:**	**%**
Total Interviewees:	**3**	**3**	**2**	**2**	**3**	**2**	15	
Made comments:	**2**	**3**	**1**	**1**	**2**	**2**	11	73%
Category:								
Chair as Coach / Management		1		1		1	3	27%
Chair - focus on Stakeholders				1		1	2	18%
Facilitates Board Engagement	2	5		1	1	2	11	100%
Chair as Innovator/Leader		1	1		2	2	6	55%
Governance - gets it done	1	3	1	1	1	2	9	82%
Total:	3	10	2	4	4	8	31	282%
# Citations per Source:	1.5	3.3	2.0	4.0	2.0	4.0	2.8	

In analyzing the importance of an Effective Chair, several observations emerge. First, the group that commented the least on the importance of the chair were board chairs themselves. Intuitively we can assume that an effective chair is a critical ingredient for an effective board and therefore good governance. I see this low score as simply the board chairs being somewhat modest about how important they are. However, the other directors who sit on the board gave a ringing endorsement on the importance of the chair with 10 citations from the three board directors.

It is interesting to note that the international experts stressed the importance of the chair in generating good governance, but did so in the context of non-

Canadian banks with which they were familiar, and which faltered because they did not have an effective chair:

> **"If you are the chief executive and making a significant strategy proposal at the board, for an acquisition or a major new product, the chairman is to ensure serious board discussion around the strategic proposal, to encourage board members to participate including the right amount of time and atmosphere, to expect them [board directors] to contribute, and to get rid of them if they don't. This is really tough. It is not the role of the chairman to make the board room collegial."** – International Expert

> **"I think the reason that these results have not proven out is that US companies have Lead Directors. These Lead Directors tend to play some of the same functions in terms of calling executive sessions and making inputs to the board agenda, etc.. But I have been impressed with the non-executive chairman of the Canadian Bank boards. They have been very initiating and very "go ahead" directors."** – International Expert

The subcategory that received the most comments was Facilitates Board Engagement with nine citations, and that was closely followed by Governance—Gets It Done with nine citations. Comments included:

> **"One of the ways is to have a vigorous discussion "in camera" before and after each meeting, led by a chair who is a director, who I think would encourage thinking outside the norm and possibly raising the flag if he could tell we were all lining up to strongly in one direction."** – Board Director

> **"The board needs to be looking at how they can assist management, support management, challenge where appropriate but also contribute to building value. That includes having the processes, the attitudes and good relationships between board members and having an effective Chair which is hugely important. It's a matter of how the chair runs the board. It is important."** – Board Director

> **"It starts with "tone at the top", and the priorities identified by the Chairman of the Board, the Board, and the CEO. That is one of the single biggest factors driving it (good governance)."** – Chief Risk Officer

While this category ranked #20 in importance, I believe this result was somewhat skewed by a lower than normal amount of comments from the board chairs themselves. Board directors, chief risk officers, and experts generally acknowledged the importance that the chair plays at the board and the chair's ability to facilitate discussion, setting the tone from the top, as well as in creating an atmosphere of trust while still ensuring that business decisions are being made. How the chair conducts themselves at the board is critical and the selection of the board chair is equally critical in achieving good governance.

This ends my review of Hilb's "Keep it Strategic" Principle. I now turn my attention to the third Principle: "Keep it Integrated".

3.5.3 Keep it Integrated

15. "Targeted Board Selection, Feedback and Evaluation" – Matters:

"The Risk Management Committee in our case is the result of a competency matrix recruitment we made to the Board, through what we called our "board renewal" process. The Committee is now headed by (a recognized industry expert)" - Bank Executive

Category 15 – Targeted Board Selection, Feedback & Evaluation:

Targeted Board Selection, Feedback and Evaluation				Canadian	Foreign		Cited
	Chairman	Director	CEO	CRO	Expert	Expert	Totals:	%
Total Interviewees:	3	3	2	2	3	2	15	
Made comments:	3	3	2	2	3	2	15	100%
Category:								
Director Selection / Experience	3	2	3	2	6	3	19	127%
Director Time	3	1		2	2	1	9	60%
Board Evaluation & Feedback	1	2	2				5	33%
Board Development/Renewal	3	2	2		5		12	80%
International Skills & Subs	2	1			4	2	9	60%
Total:	12	8	7	4	17	6	54	360%
# Citations per Source:	4.0	2.7	3.5	2.0	5.7	3.0	3.6	

Every interviewee made comments on the category "Targeted Board Selection, Feedback and Evaluation", underscoring the importance that board makeup and improvement processes play in generating good governance. This category ranked #11 of the 22, with 54 comments being provided.

What is interesting to note is that these views were most strongly held by the Canadian experts (5.7 citations each), closely followed by the international experts (3.0 citations each). These experts work outside of the day-to-day banking operations and may be somewhat more theoretical in their views. However they strongly endorse the need for effective selection of board directors, and effective monitoring and management of director performance.

The following comments support these observations:

> **"Our (Canadian) Corporate Governance focuses more on the recruitment of individual directors with competencies and skills, and the assessment of these directors which the US did not have and still does not have."** – Canadian Expert

> **"Group Think can also be addressed by having more experts on boards who do really understand the industry and some people have suggested "well that would be a problem because everyone would just rely on that person" and that is not what we are suggesting. I think that adding people from different ages, male – female, different backgrounds, etc. can help avoid this Group Think problem."** – Canadian Expert

> **"In the US for example they didn't have the requirement to recruit on the basis of competencies and skills. They just have a requirement for independent committees and independent directors. So bank boards in the US, until the financial crisis had directors, who did not have banking experience. When I interviewed directors on bank boards they tell me: "I don't understand the risks when I'm being asked to approve something". They don't want to raise their hand."** – Canadian Expert

Board chairs offered 4.0 citations on average each and they supported the views of the experts. Board chairs play a critical role in facilitating and monitoring board effectiveness. The chairs I interviewed demonstrate that Canadian bank board chairs are actively engaged in the director selection process, as well as the evaluation and feedback processes as indicated by the following representative comment:

> **"And I also think it's important to have people that don't have banking experience who say: "Why do you do that"? or "How do you do that"? or "What on earth do you mean by that"? - where you can't take for granted stuff that uses bank buzzwords."** – Bank Chairman

Demonstrating a divergence in views on the importance of this category, again we see executives (CEOs and chief risk officers) comment the least on the importance of these activities to achieve effective governance. I conclude that executives feel that good governance stems from their day-to-day operational activities more than from the activities of having Targeted Board selection and the evaluation and management of the board.

However the entire interviewee group was aligned in recognizing the need for continuous improvement of the board and its governance processes through regular reviews, feedback and board renewal. Comments include:

> **"Every bank has a consultant, obviously Oliver Wyman or McKinsey, taking a look at their practices. We've had a consulting firm in there for the second time in five years, doing what they call a health check (of the Board)."** – Board Director

> **"One area we are focusing on is the need for third-party reviews. We believe that the board should occasionally have outside firms look at the effectiveness of their Risk function. That is something that has been mentioned in other international reports, but we don't see a lot of activity happening yet – we see some but not a lot."** – Canadian Expert

> **"We underwent a transformation about two or three years ago. We had a structure that had been in place for a long time and had probably lost its meaning. We said let's just back up and review this from a corporate governance perspective. We have to establish what we see are the right committees."** – Chief Risk Officer

I conclude that Targeted Board Selection, Feedback, and Evaluation plays an important role in the creation of an effective board. This is supported by all fifteen interviewees, although predominantly the expert groups and board members stressed these views.

16. "Targeted Development of the Board" – Matters:

"We also spend a lot of time on what we call "training sessions" – sessions with an individual department head. We said: "Come in and do one page of points you want to make with the Board as to what your job is, and then we are going to ask questions. Talk about strengths, weaknesses, opportunities, and threats, issues, what keeps you awake at night, what is your job." - Bank Chairman

The category Targeted Development of the Board ranked near the top, at fifth of the twenty-two categories and receiving sixty-six comments from fourteen of the fifteen interviewees (see table 29). Only one of the directors did not explicitly mention this category. What is interesting to note is that the Canadian experts spoke the most about the need for development of the board with all three Canadian experts commenting on this category with an average of 7.3 citations per interviewee. This group particularly stressed the sub-category Board Renewal.

Category 16 – Targeted Development of the Board:

Targeted Development of the Board						Canadian	Foreign		Cited
			Chairman	Director	CEO	CRO	Expert	Expert	Totals:	%
	Total Interviewees:		3	3	2	2	3	2	15	
	Made comments:		3	2	2	2	3	2	14	93%
Category:										
Individual Directors			2			1	4	1	8	57%
Board Teams			3	3		3	4		13	93%
Entire Organization			1	2		1	4		8	57%
Strategic Renewal			3	3	4	5	9	5	29	207%
International subsidiaries			1	2		2	1	2	8	57%
		Total:	10	10	4	12	22	8	66	471%
# Citations per Source:			3.3	5.0	2.0	6.0	7.3	4.0	4.7	

Comments included:

> **"So Sir David Walker [the Walker review 2009] came out in his interim report and said the (Board) Risk Committee should have access to education, access to a budget, access to outside advisers."** – Canadian Expert

> **"And they [board directors] don't fully understand social media. I gave a speech on Saturday to 100 Directors - I said "put your hands up if you use social media". There were four hands that went up."** – Canadian Expert
> **"Back in the 1980's there was a movement to get independent directors on the boards. There was a huge push back. But today it is just accepted that this should be the case. It is also accepted today that there should be a separation between Chair and CEO, and that was something that most boards fought vehemently against."** – Canadian Expert

> **"Since the crisis we now have Chief Risk Officers [in all of the banks] reporting to the CEO and also having a "dotted line" to the Board. That is something we look for and a number of institutions have made these changes."** – Canadian Expert

Chief risk officers mentioned this category the second most with an average of 6.0 citations per CRO across the 17 interview questions. Managing risk is of paramount importance to a good board and understanding these risks is critical. One of the CROs felt that it was often his responsibility to educate board members on the nuances and idiosyncrasies of complex products and major transactions in the bank. Discussions in the committees provide opportunities for developing better informed directors and therefore a better board. Also when the media reports an industry breach of governance additional questions are raised. Development of the Board occurs both formally and informally.

CRO comments include:

> **“For instance, on an annual basis we have an hour long discussion on risk issues with the full board so that they have a comprehensive understanding of the risk environment, the risk profile and where we are at. And then we have quite a comprehensive quarterly "enterprise risk report" that is the focus of fairly intense review by the risk committee of the board, but it gets distributed to all directors and there is often some degree of discussion at the board.”** – Chief Risk Officer

> **“In the more high-profile subsidiaries they (Board Directors) have got very good visibility on their issues. For example the capital markets business in the US, Canada and Europe, and a fair bit of it gets carried out in subsidiaries - the board would be quite familiar with that. But I would say that the focus at the board is managing the lines of business and that the legal entity overlay is more limited.”** – Chief Risk Officer

> **“We introduced an Enterprise Risk Management Committee which was the top-level (Board) committee. It had all of the business units and control units on it and they were charged with the responsibility for oversight of risk in the enterprise. This was supported the other executive and Board committees.”** – Chief Risk Officer

The third most outspoken group were the directors. Board directors as a group and individually have direct responsibility for governance and oversight for these banks. But chief risk officers and Canadian experts both indicated that individual directors may not have detailed enough banking expertise to be comfortable in making their decisions. As pressure increases on the boards and each director, the directors underscored the importance to improve their knowledge and familiarity especially in such extensive organizations that are involved in complex products and transactions.

Comments from this group include:

"So we started on a journey. And it was not an overnight one. I think it took us a number of years to get to where we were leading the pack. We were the first to go with a lead chair and others followed, and we also started a lot of other new initiatives. A lot of the input came from getting good feedback from the board and having a Chairman who spent the time needed to get that feedback." – Bank Director

"We got very beady-eyed about improving the process and having a "process" to improve the process – a proactive approach to find the right governance model." – Bank Director

This category ranked fifth of twenty-two. I can conclude that continual development of the board is critical for the on-going success of corporate governance in these banks. Having a well-informed board through targeted development of the group as well as the individuals and periodically conducting a holistic review of the whole board with the intent of "Strategic Renewal" makes these boards stronger and the Directors more knowledgeable.

17. "Integrated Board, Subsidiaries and Management" – Matters:

"I sit on the subsidiary board not because I am Chairman but because we said we should have one representative from the Main Board on the US board and I volunteered before I became Chairman of the Board. We have other executives as well." – Bank Chairman

Category 17 – Integrated Board, Subsidiaries and Management:

Integrated Board, Subsidiaries and Management					Canadian	Foreign		Cited
	Chairman	Director	CEO	CRO	Expert	Expert	Totals:	%
Total Interviewees:	**3**	**3**	**2**	**2**	**3**	**2**	15	
Made comments:	**3**	**3**	**2**	**2**	**3**	**2**	15	100%
Category:								
Integrated Board Governance	10	10	3	12	5	4	44	293%
Integrated Sub. Governance	10	11	4	5	6	4	40	267%
Integrated HQ & Subsidiaries	10	9	4	6	7	7	43	287%
Integrated Boards & Mgmt	14	10	10	8	6	3	51	340%
Total:	44	40	21	31	24	18	178	1187%
# Citations per Source:	14.7	13.3	10.5	15.5	8.0	9.0	11.9	

This category was ranked number one in my research, receiving a total of 178 citations from the interviewees (see table 30). All fifteen interviewees made comments in this category, underscoring the importance that the board, management, and the international subsidiaries need to be closely integrated within the company in order to achieve and maintain effective corporate governance at home and internationally.

Hilb's principle, Keep It Integrated, tells us to examine corporate and board approaches to targeted selection, evaluation, remuneration, and development of board members as well as ensuring integrated board-management Committees. In my research of international subsidiaries I start by examining the integration between the board and management, to investigate the integration of processes, people, systems and governance practices in the head office environment between management and main board, and then how these practices and processes are extended into the international subsidiaries and to the subsidiary boards.

From my research, several key observations emerge. First, while every group made significant comments on this category, the experts, both Canadian and international, commented below the average at 8.0 and 9.0 citations respectively. The number of citations they made is material and this actually highlights all the more emphatically how board chairs (with 14.7 citations), board directors (13.3 citations), CEOs (10.5 citations) and chief risk officers (15.5 citations) all emphasize the criticality of this integration for good governance in the banks' international subsidiaries.

Secondly, all subcategories received a great deal of attention from the interviewees. For example, the subcategory Integrated Boards and Management was cited fifty-three times. Comments included:

> **"When the Bank's Risk Committee is in full tilt, you have got two people from the risk department plus the chief legal officer, the chief financial officer, the internal auditor, and then at the end of the table depending on the topic as many as five other responsible people from the organization. There is a huge amount of interaction with the operating executives."** – Board Director

> **"You need an excellent relationship between the board and management; and a relationship of trust; and you need the understanding that the board is trying to bring value to the company together with management."** – Board Director

The sub-category "Integrated Board Governance" was cited 44 times with the following comments:

> **"What I find interesting is that the subsidiary board feels responsible for "governance" which includes Audit, Risk Management, and things that their regulator looks at. That's what they feel responsible for. But, if the earnings are not very good, there is no sense of ownership or pride [for earnings in the US board] – it's not their stock."** – Bank Chairman

> **"Our economic briefings, such as the ones we had today, start with United States. We (main Board) are very aware of things like the Dodd-Frank Act and the Comptroller of the Currency. We had a full briefing today on the recent review completed by the Fed, who came in, and then the Office of the Comptroller of the Currency came in, and then there were four other agencies. The Canadian bank Board had a complete and detailed briefing from the chief executive officer, the chief financial officer and the chief risk officer on the nature and content of those reports. The questions they (regulators) ask are detailed. So we have an intimate knowledge of the US operation."** – Board Director

> **"I think from a governance perspective it is essential that Management of the parent bank, and the Board understand the international operations. They have got to understand things like the cultural differences. There have been lots of examples where banks in Canada have said they did not get the value they wanted. And often those banks tried to run their subsidiaries the same way they run their business in Canada, only to discover that it doesn't work. When you're making an international acquisition the Canadian bank has got to ask: "What are the cultural differences; What are the minimums that have to be there ["Global Effectiveness"]; What parts am I prepared to vary based on local conditions ["Local Responsiveness"]?** – Board Director

> **"This is also where "Enterprise–wide Standards" also plays a role. The point is we have standards which is not "here's the Asian version", and here's the "European version". For example the Code of Ethics applies right across the board."** – Chief Risk Officer

The sub-category "Integrated HQ and Subsidiaries" was cited 43 times and provided the following comments:

> **"We (main Board and subsidiary Boards) meet together once a year. We meet as a joint board and have a session generally looking at (the subsidiary) strategy**

together. So we get a chance to hear each other and what we are thinking.” – Bank Chairman

“If you were to go into our branches and offices, you'll see the values of the bank. When we try to figure out how to do something not listed in a policy book or a manual, and many of the things that we encounter like that [decisions requiring management discretion], the Values helps to guide the decision.” – Bank CEO

“In our case in our subsidiaries we have bank Management on the boards of those (subsidiaries). Those executives are involved with the governance of the parent bank. That is the connection line.” – Bank Director

“You want to have a good blend of home country procedures with local country knowledge of risk and marketplace [glocal - Hilb]. I don't think that there is a rulebook on how to do that. I have seen many different approaches.” – Canadian Expert

“Our head of International is traveling all the time and then he’s back, sitting in on the credit meetings in Toronto. There are very strong linkages between what's going on in the field and what's going on centrally.” – Bank Chairman

The sub-category “Integrated Subsidiary Governance” was cited 40 times:

“There are other mechanisms – board manuals, governance standards, the Subsidiary Governance Office, there is documentation to explain to (subsidiary) directors how we do things. They (subsidiary directors) also have Management on those boards or in some cases we have external directors from the parent board on the subsidiary board. So there is very clear communication on how things work”. – Chief Risk Officer

“There is a section at every [main] board meeting that we cover (the international subsidiaries) because it is the most important thing that we have going on. I always set aside half an hour so they are reviewed at every board meeting.” –Bank Chairman

“You know what I find useful is I sit on the Risk Committee and there have been some things that, at the subsidiary board in the US that I see. It's rare but I have turned to management and said "we have to review that at the Canadian Risk Committee – we can't just leave this one here". These would be important issues. Things can slip through the cracks.” – Bank Chairman

“Next week for example were taking (our main Board) to Thailand and then to China. Our board has been to most of our key regions where they have had first-

> **hand experience. We have also talked about the need to get better representation at the board. We have an Asian director and we have a Latin American director, and 2 out of 15 is not an unreasonable balance."** – Bank CEO

I conclude that the holistic approach these banks follow in their organizations is critical for business success as well as success in corporate governance. The above comments are of particular importance to my research on corporate governance of international subsidiaries. Good governance in international subsidiaries first starts with good governance principles and practices at the parent organization and effective processes between the board and management, though the integrated committees.

Extending good governance to International subsidiaries then requires a complex series of integration connectors that align the main board with the subsidiary, and the main board with the subsidiary board. Many different techniques are used to accomplish this integration between the main board and the subsidiary board, including: having the chairman or other directors of the main board sit on the subsidiary boards; having the same people sit on the risk committees for both the board and subsidiary boards; having international directors on the main board; having the main board visit the subsidiaries; having the subsidiary board and directors attend the main board meetings and board committee meetings; having subsidiary regulators attend main board meetings and audit committee meetings with the parent board; developing local employees and management to run the subsidiaries consistent with the bank's culture and ensuring enterprise-wide standards are in place; ensuring that "Link-Pins" (Hofstede) are actively employed in subsidiaries, as well as ensuring that local risk managers are operating in each subsidiary reporting independently to the chief risk officer in the parent organization. These are critical findings for my research.

18. "Good CEO" (Stewardship Theory) – Matters:

"From my perspective Canadian Chairmen and the CEO's in particular just quietly get on with it. Rick Waugh (CEO Scotia) is an example. Rick is a guy who just gets on with the job, you know, "feet under the table". I have seen Rick in many capacities, and he is just a massively professional banker." – International Expert

Category 18 – Good CEO:

Good CEO (Stewardship Theory)						Canadian	Foreign		Cited
		Chairman	Director	CEO	CRO	Expert	Expert	Totals:	%
	Total Interviewees:	3	3	2	2	3	2	15	
	Made comments:	3	2	2	2	2	2	13	87%
Category:									
CEO as Stewart		2	2	4	2	2	2	14	108%
CEO as Leader / Innovator		2	4	1	3	2		12	92%
CEO Skills / International			1				1	2	15%
Issues of Dominant CEO		1			1	1	1	4	31%
	Total:	5	7	5	6	5	4	32	246%
	# Citations per Source:	1.7	3.5	2.5	3.0	2.5	2.0	2.5	

This category did not receive as many citations as I had anticipated (see table 31). As taught in every business school, leadership plays a tremendous role in organizations by creating vision and setting tone from the top. General Electric's former CEO, Jack Welsh, is often used as an example of the impact that leadership can play in organizations. Leaders also can have a tremendously negative influence in organizations (as I presented in Section 1), when for example CEO Ken Lay perpetrated the Enron scandal. The influence that the CEOs play in the Canadian banks and the effect that stewardship theory plays is an area of interest in my research. As mentioned above, one international expert directly referenced the important roles that the CEOs play in creating stability in the Canadian banks and he particularly directed a lofty compliment toward Rick Waugh, CEO of Scotiabank. However, this category accumulated only thirty-two citations from my interviewees, and ranked twentieth of twenty-two. In spite of the one glowing reference, the information provided by my interviewees was inconclusive that good corporate governance can be attributed to the influence of the CEOs in these banks.

However, several interesting observations do emerge. In my interviews, board chairs occasionally discussed their own roles. For example one bank chair explained: "I have to draw on directors that are knowledgeable," making reference to his need to manage the board dynamics. However, CEOs rarely referred to themselves in my interviews. CEOs expressed more of a holistic view of their role in leading a management team. This seems to endorse the comment made by the international expert when he describes Canadian CEOs as people who simply get on with the job. I see this as an important observation.

Board directors and chief risk officers spoke the most about the important role the CEO plays particularly pointing out their leadership and innovation skills. Comments included:

> **"We had (named CEO) as chief executive officer who was also the chairman in the early 1990s. He was extremely interested in corporate governance. So he took the board of the bank down from 35 to 18 people and instituted a number of reforms including the establishment of a lead director. I think he was the catalyst to change bank board governance in Canada."** – Board Director

> **"I think of (named CEO). He read the fine print or some of his people read the fine print on asset-backed commercial paper, they decided not to go in it, because they couldn't understand what the heck was under pinning the asset."** – Board Director

> **"Another part of the transition was our leadership – (named CEO) came in and there was a new head of the Dealer. We have a process that says we're happy to do anything that we understand, but we have to understand. So I think it was a cultural transition that was initiated by (CEO) with a laser focus on understanding what our strategy is and making sure that we are doing things that are consistent with it."** – Chief Risk Officer

Many interviewees discussed the importance of leadership in banking and pointed out the negative effects that dominant CEOs can play in a bank, citing non-Canadian banks as examples. Comments included:

> **"I can remember before the crisis hit totally, Citibank's CEO was saying "we are up there and we are dancing. And as long as the music keeps playing, we've got to keep dancing". Meaning, we are making a lot of money in this business and we have got to be there regardless of the merits of it. Well, if that's what the CEO is saying (in public) and the board is not cognizant of it, then that is a bad situation."** – Bank Chairman

> **"And then there are some other basic things (on Governance). These are well documented in books and include things like domineering CEOs. There are many things that can be at play that can affect it [a Board's effectiveness]."** – Canadian Expert

> **"In Europe the chief executives are often quite colorful, opinionated and self centered – I mean that's true of Deutsche, that's true of BNP that's just an observation of fact. Perhaps that's true of Barclays Bank. It's certainly been true from time to time of Citibank. It's certainly true of Bank of America. Whereas in the**

> **Canadian banks, these guys are in their offices in Toronto and they are just running the bank."** – International Expert

Similarly, the CEO's themselves are clearly aware of the need for effective stewardship in their roles. Comments included:

> **"That was a choice - the probabilities were small that additional capital was required, but we raised capital - it was purely for safety – soundness. You are a steward of an institution as well as a representative of shareholders."** – Bank CEO

> **"And that is a cultural difference. This is a 140 year old institution with 40,000 employees – we are not going to calibrate too finely the difference between shareholder return versus safety–soundness."** – Bank CEO

Several conclusions emerge from this category. Canada's banks do appear to have effective stewardship in their CEOs. Succession planning is critical for success in governance and seems to be effective in Canada. There was no reference to any CEO demonstrating the characteristics of a "dominant CEO" in spite of these leaders' holding significant leadership roles. Effective governance is being attained but it seems to emerge from a holistic system of processes and practices rather than relying on any single individual including the CEOs.

19. "Effective Management and Company Culture" – Matters:

"There is also our corporate culture which may be just a different slant from the "tone from the top". We have a culture where we do things right and we do the right things. Everyone wants good results but Management also wants them done the "right way". I do think our cultural plays an important role." – Bank CEO

Good governance presumes a prerequisite of effective management. During the interview phase this category was expanded to also include company culture as a component of effective management as culture was regularly referenced as being critical to effectively managing these banks. In the end this revised category ranked sixth of the twenty-two, receiving sixty-two comments (see table 32). Further, these interviewees directly connected effective management and company culture with good governance both at home as well as in these banks' international subsidiaries.

Category 19 – Effective Management and Company Culture:

Effective Management and Company Culture					Canadian	Foreign		Cited
	Chairman	**Director**	**CEO**	**CRO**	**Expert**	**Expert**	**Totals:**	**%**
Total Interviewees:	**3**	**3**	**2**	**2**	**3**	**2**	15	
Made comments:	**3**	**2**	**2**	**2**	**3**	**1**	13	87%
Category:								
Mgmt Foresight & Diligence	1	2		2	2		7	54%
Mgmt Execution & Control	5	3	2	3	2	1	16	123%
Strong Managers & Teamwork	4	1	2	1	1	2	11	85%
Glocal Mgmt & Processes	1	2	1	2	1		7	54%
Culture as Management Tool	7	2	4	4	4		21	162%
Total:	18	10	9	12	10	3	62	477%
# Citations per Source:	6.0	5.0	4.5	6.0	3.3	3.0	4.8	

Being so highly ranked relative to the other categories underscores the importance that the category Effective Management and Company Culture is seen to play in creating effective governance in these Canadian banks. With the exception of one Director, all bank insiders (board chair, directors, CEOs and chief risk officers) commented on the importance this category plays in achieving good governance. Comments included:

> **"Relative to other banks in Canada, I'd like to say we performed better than they have. We worked very hard to maintain liquidity. We worked very hard to maintain a high capital ratio, more than we needed. I don't know if we can put ourselves on a pedestal, but I will say that the management of the bank took it very seriously in terms of maintaining capital and ensuring we were liquid."** – Bank Chairman

> **"You are always thinking safety – soundness. We really were earlier than anyone else to recognize that this recession crisis is potentially different and we needed a much larger margin of error around the safety – soundness issue. We raised capital much earlier than anyone else, and that was the distinctive element."** – Bank CEO

> **"I think the most important thing when thinking about this from a practical or an academic point of view is the fact that a board spends a fraction of the time that management spends on the business. The first line of (Governance) responsibility in all of this has to come from effective management."** – Bank Chairman

> **"I think there is too much emphasis being put on boards, and not enough recognition that having really good management people with a broad understanding and exposure to the business, with a credit and risk culture, with clear checks and balances, with compensation systems that reward the right behaviour and penalize the wrong behaviour - these are the really important issues."** – Bank Chairman

There was heavy emphasis on two sub-categories. The sub-category "Culture as a Management Tool" was cited 21 times:

> **"It starts off with two things: first, it's "tone at the top"; and secondly it's the values of the bank. I'm sure that every good company that aspires to that [good governance] will say something similar and that is where we bring in the Values. We talk about it as our unique culture."** – Bank CEO

> **"As I said, all levels of management are involved with managing risk. It's a very strong risk culture, compared to some others."** – Bank Chairman

> **"One key element is culture. I have come to the view after 14 years, that each of the banks in Canada has a very strong culture. Each bank has its own individual culture – and each culture is unique. But all of the banks at their core have a very strong desire for excellence."** – Canadian Expert

> **"And you have to look at these as hard and soft controls. The cultural things we talked about are obviously the soft controls. The segregation of duties and other processes are the hard controls. The culture is set by the board. Boards may not want to accept that they control the culture, but that would be denial because they do control the culture, by the selection of the management team, by the treatment of ethical risks in the workplace, by the approval of the Code of Conduct, by the whistleblowing procedures, by the tone that is set at the top – whether they like it or not, they determine it."** – Canadian Expert

The sub-category "Management Execution and Control" was cited 16 times:

> **"One of the things that struck me about the banks who do a good job internationally is how effective they have been at bringing their senior people through the corporate ranks and ensuring they get international experience: sending head office staff out to obtain international expertise, and by brining international subsidiary staff into head office and allowing them to (get promoted) up the line like that."** – Canadian Expert

> **"I probably could go along with a lot of other things but let me focus in on another key element which is "execution". You have to have people who worry about what is good governance. What are the elements you need to execute on? How do you do the continual renewal and improvement of structures and processes? There is a willingness and desire to make sure that we actually have things in place that get the right level of transparency; that we get decisions made with the right facts, by the right people following appropriate process, and it being clear. And then after the**

fact examining how you did what you were doing. So the execution part of this is actually quite significant." – Chief Risk Officer

"This bank was one of the first banks to develop a more explicit Risk Appetite statement, and then drove that through the organization. You can look at that as a kind of a compliance exercise, or you can say this might help us have focus - it can better define where we want to be and how we can get there." – Board Director

The conclusions from this category include: (a) Generating good governance requires a proactive and diligent team in management who share responsibility for risk management within the bank. (b) Effective management requires having effective controls in place and that includes both soft controls as well as hard controls. One of the soft controls is the bank's culture. (c) The importance of bank culture is a recurring theme from these interviews and recognized by board members, executives, and experts. Bank culture in these Canadian banks exists both at home and across their international franchises. This is an important conclusion for my research to explain how these banks generate good governance both at home and in their international subsidiaries.

3.5.4 Keep it Controlled

20. "Auditing and Risk Management Function of the Board" – Matters:

"Take international for instance – what they are doing may be too small for the Risk Committee that looks at big Risks. Not so for Audit. Audit will see right away – the number of audits, the number of fails, the number of deficiencies and time to correction of deficiencies. Where you get your first flags and your first monitoring on foreign subsidiaries is always through Audit." - Bank CEO

I now turn my attention my last 3 research Categories that address Hilb's 4th Principle of New Corporate Governance: "Keep it Controlled".

The category Auditing and Risk Management Function of the Board ranked as second among the twenty-two categories with 139 citations made during the interviews (see table 33). It was again the bank insiders group that stressed the importance of these control mechanisms for generating good governance, and in particular the chief risk officers with an average of 12.0 citations each from the two CROs interviewed.

Category 20 – Auditing and Risk Management Function of the Board

Auditing and Risk Management Function of the Board						Canadian	Foreign		Cited
			Chairman	Director	CEO	CRO	Expert	Expert	Totals:	%
	Total Interviewees:		3	3	2	2	3	2	15	
	Made comments:		3	3	2	2	3	2	15	100%
Sub-Category:										
Auditing Function of the Board			2	1	2		1	4	10	67%
Independence of Audit/Risk			1	3	3	2	3	3	15	100%
Risk Management & Diligence			10	12	3	11	4	5	45	300%
Risk Measures & Controls			8	12	7	8	1	6	42	280%
Risk Planning & Innovations			3	3	2	1	4	1	14	93%
International Risk Measures			4	1	3	2	1	2	13	87%
		Total:	28	32	20	24	14	21	139	927%
# Citations per Source:			9.3	10.7	10.0	12.0	4.7	10.5	9.3	

Comments that pertained to the Auditing function of the Board included:

> **"The CFO has direct access to the Chairman of the Audit Committee - they have a special relationship. He has a direct line to the CEO with a dotted line to the chairman of the Audit Committee."** – Bank Chairman

> **"We report these things (breaches) to the regulator, and to the board, and then there is a fire drill. Audit looks at it. Sunlight is the best disinfectant. That is how those things are handled."** – Bank CEO

> **"I think they (the main Board) are very aware of it (governance issues in international subsidiaries) and the Audit committee particularly."** – Bank CEO

> **"The Risk committee looks at overall risks which are [large]. Not so for Audit. Audit will see them (problems) right away – the number of audits, the number of fails, the number of deficiencies, time to correction of deficiencies. Where you get your first flags and your first monitoring that comes up on foreign subsidiaries is always through Audit, and not through Risk."** – Bank CEO

> **"The Audit Committee looks back at what happened – did you do everything correctly according to the framework we laid down, by the regulator, by the principles of conduct, and all the rest – did we do the stuff properly? And what's the consequence to the balance sheet, the numbers as stated in financial accounting terms, and all that. The Risk Committee looks forward – if we do this what is the implication for our exposure, our franchise operation, our market credit, is it within the Appetite we have determined? That is the Risk Committee's function – looking forward."** – International Expert

Comments that highlighted the Risk Management function of the Board included:

> **"We have a Risk Management committee. Without question it is the most interesting committee to be on. That is where the major issues of the bank come forward. We work very hard at it."** – Bank Chairman

> **"The Chief Risk Officer also has direct access to the Chairman of the Risk Committee. If there was ever a situation where the CEO was ignoring his advice, I expect the Chief Risk Officer would blow the whistle by calling the Chairman of the Risk Committee if not me, the Chairman of the Board."** – Bank Chairman

> **"You know what I find useful is I sit on the Risk Committee and there have been some things at the subsidiary board in the US that I see. It's rare but I have turned to management and said "we have to review that at the Canadian Risk Committee – we can't just leave this one here".** – Bank Chairman

> **"All the banks have a two tier columnar process for decision-making. There is a business originator, then there is the risk people offset from the originator. They are joined at an escalating level depending on whether there are disagreements. Issues are escalated to the risk committee after reviews by management."** – Board Director

> **"The Risk Appetite statement is board approved. We take it very seriously with a focus on improvement. This is a high-level statement of our risk tolerance and our acceptance of risk, but it's not just about risk [mitigation]. Our organizations are in the business of taking risk. So the issue isn't just about minimizing risk – it is examining risk-return."** – Board Director

> **"There is more respect for Risk in Canada, I believe. And when you look at the disasters that have happened, including UBS just a few weeks ago, the appreciation of internal controls and the understanding of internal controls is significant."** – Canadian Expert

> **"The Canadian banks were among the first banks to have board level Risk Committees with Chief Risk Officers."** – International Expert

> **"One other element of this process is the "in-camera meeting" with the independent directors of the committee, plus the chair and just the Chief Risk Officer. The purpose is (for the Board) to have direct access to the Chief Risk Officer and to raise issues and questions with me. It's a good mechanism for unstructured discussion around a few issues."** – Chief Risk Officer

An interesting observation made several times during the interviewing process is the important role that having an international strategy plays as a risk diversification strategy for these banks and to stabilize their global earnings.

Comments to support this as a risk diversification strategy included:

> **"We are very well diversified. Basically we have four business lines: Canada - personal and commercial banking; International - which is personal and commercial banking as well; Global Wealth Management and Capital Markets. We are well diversified in our business lines."** – Bank CEO

> **"But looking at our subsidiaries and other countries - we have had our share of problems, but even in our worst years, 2009 and 2010, we still made a 16% return on equity. Canadian banking would not have been as good."** – Bank CEO

> **"I think it (International Strategy) is very important. It's not good thing to have all of your "eggs in one basket". Moving into other countries can make the bank more diversified, especially if you move into countries that have good prospects. This international presence can be quite important for future growth."** – Canadian Expert

Conclusions from this category are: (a) the Auditing and Risk Management functions of the board are critical for success in good governance. (b) We learned that Audit will often be the first indicator of weaknesses in the organizational. Audit is typically a centralized function under a chief auditor who reports to the board's audit committee and usually the CFO. (c) The audit teams travel to the international subsidiaries. This may be one of the few but regular opportunities to see inside these subsidiaries to review both the micro audit issues as well as to sense any macro (management, moral, etc.) issues within the banks. (d) Although audit is backward looking it is very prescriptive and measures the performance of the subsidiaries based on predefined measures [Global Effectiveness] that are important to the board. This function can proactively detect subsidiaries that are slipping into trouble as well as specific issues such as trading frauds, before they occur or before they get too large.

The risk committee plays a crucial role for bank governance. This is where we have seen so many failures such as subprime debt, or the 2012 JP Morgan[265] $ 5

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[265] Forbes Magazine – "The Real Loss For Jamie Dimon And JPMorgan Chase: Their Integrity" - July 13, 2012

billion write-off due to inappropriate hedging, something our interviewees discussed in reference to the Manulife debacle of 2009. Risk management takes on many component parts including (a) an independent reporting stream to the board, (b) measures for risk sizing including risk appetite and other binary measures, (c) measures for testing risk, including stress and scenario testing, and (d) in the end understanding the trade-off between risk and return in these institutions that actually make money by taking risk in their lending and trading products in addition to the more traditional risks that all businesses face (economic risk, systemic risk, operational risk, etc.).

These are crucial findings in my research. What is particularly interesting is the acknowledgment that international expansion is in fact a risk mitigation strategy by introducing business and economic diversity to these banks operating portfolios. All of these are important conclusions of this Category.

21. "Controlling Function of the Board" – Matters:

"And you have to look at these as hard and soft controls. The cultural things we talked about earlier are obviously the soft controls. The segregation of duties and other processes are the hard controls". – Canadian Expert

Category 21 – Controlling Function of the Board:

Controlling Function of the Board					Canadian	Foreign		Cited
	Chairman	Director	CEO	CRO	Expert	Expert	Totals:	%
Total Interviewees:	**3**	**3**	**2**	**2**	**3**	**2**	15	
Made comments:	**3**	**2**	**2**	**2**	**2**	**2**	13	87%
Category:								
Good Controls	6	3	7	9	4	1	30	231%
Communication Function	3	1		4	1		9	69%
Evaluation of the Board	1				2		3	23%
Holistic Perspective	2	3			2	1	8	62%
International Controlling	6	3	1	2			12	92%
Total:	18	10	8	15	9	2	62	477%
# Citations per Source:	6.0	5.0	4.0	7.5	4.5	1.0	4.8	

The category Controlling Function of the Board was another addition to my research framework as a result of incorporating Hilb's framework (see table 34).

See: http://www.forbes.com/sites/nathanvardi/2012/07/13/jamie-dimon-and-jpmorgan-chase-lose-their-integrity/

This category was highly credited for good governance in my interviewees and ranked eighth of the twenty-two categories.

As we have seen previously, “bank insiders” with a focus on the day-to-day operations inside their banks once again collectively commented the most on the importance of controls in achieving “good governance”. All bank insiders spoke to this subject. Chief risk officers led in this category. The 2 Canadian experts also supported the banker’s views on the importance of a controlling board.

Comments included:

> **“Strong central office financial controls, whether it's through internal audit, whether it's through external audit, or whether it's through the financial function, there is strong oversight. And then there is a strong centralized credit control. So it's one team – one goal.”** – Bank Chairman

> **“At the same time we established an Executive Governance structure that allows the flow of information and to ensure that decisions are made that are consistent with that (Risk Appetite) and is reinforced to the businesses that this is the strategy and what you have to do is you have to continually prove how you operate consistently within that strategy and why it makes sense.”** – Chief Risk Officer

> **“And you have to look at these as hard and soft controls. The cultural things we talked about are obviously the soft controls. The segregation of duties and other processes are the hard controls.”** – Canadian Expert

> **“I think most boards when they experience a fraud do go back and try to assess this. Either you need more expertise on the board, or you need to introduce additional controls, or you need independent reviews of the state of the controls and whether they do actually stand up to your peers.”** – Canadian Expert

This category included several subcategories including Communication Function of the Board, Evaluation of the Board, and Following a Holistic Perspective, but it was the two controlling subcategories that received the vast majority of the attention in this area. The subcategory Good Controls was cited thirty times:

> **“In the trading room rather than risk management sitting in a separate back room in a group of people analyzing what is going on, we moved risk management into the trading room. So right by each trader is someone in charge of risk management for that area. Now they are hand in glove together. The left-hand knows what the right-**

hand is doing. Risk management is now part of the process and can step right in." – Bank Chairman

"You try to set up a system where it is "binary", sort of yes/no checks, and where it is on a continuum you establish some metrics." – Bank CEO

"I would say that the board for any significant decision is likely to ask a risk-type question of me as the chief risk officer, asking "what is your perspective on this?" – "what are the things we should worry about?" – "have you had full involvement on this?" – "what is your perspective on the decision?" They try to make sure that they have an independent risk management perspective on key issues as they are reviewing" – Chief Risk Officer

"I think we've got fairly good mechanisms for aggregating risk and for having integrated systems and all that sort of thing." – Chief Risk Officer

"And this is all reinforced through the measurement of performance, with our balanced scorecard. I as the CEO have a balanced scorecard which is very close to the one that we show externally, which goes down to each one of our business lines. It's very tough to manage under a balanced scorecard, but it sends a message to everybody that the quantitative measurements are important."- Bank CEO

"Having two or three sets of eyes, particularly in the risk area where we keep a fairly tight lid on things with checks and double checks." – Bank Chairman

"You can look at the last 10, 20 or 30 years and we've always had the lowest loan-loss provisions among the Canadian banks. Why? This is governance. We used to say we believe in "two sets of eyes" (to review laons), well we probably have six set of eyes. They have an independent view. I never felt it was an inhibitor of growth. It protected me. When you lose a loan you lose 100 cents on the dollar. If you lose a deal you just lose 2% spread. Why wouldn't I want more opinions?"- Bank CEO

The Sub-Category "International Controlling" was cited 12 times. Comments included:

"It's no longer sufficient for us to manage risk in our European subsidiary or the UK from Canada. We have to have a Chief Risk Officer there, capital requirements have to be met by that particular entity, and this is true for all of our subsidiaries, in the US as well, and so forth. It's become much tighter than it used to be." – Bank Chairman

> **"If you were to go into most, if not all of our branches and offices, you'll see the values of the bank."** – Bank CEO

> **"As I said, we carefully study the various countries we enter and for example we exited Ireland and Greece before the crisis hit those two countries. We ended up saving our bacon there."** – Bank Chairman

> **"Banks are peculiar. In a large corporation, if you are doing business in the UK, or Southeast Asia, South America or China, those operations all report up to the top risk committee or audit committee. In a bank we have 4 control functions: audit, risk, finance and compliance."** – Board Director

> **"For example we had operations in Australia for 20 – 25 years. Did we ever have problems Australia? Not really. But we looked at it and said "how is Australia working for us as an organization and what's the importance of it?" The reality was it isn't critical to our franchise or our strategy and that keeping it probably would create a problem. In the end we withdrew."** – Chief Risk Officer

Several conclusions emerge from this analysis:

First, the controlling function of the board plays a critical role in achieving good corporate governance and in particular in extending that good governance to the foreign subsidiaries of international banks. The board sets culture through the selection of the CEO and management team; it is important to recognize the blend of hard (second set of eyes) and soft (culture or values) controls as controlling devices for the board.

Next, good corporate governance is achieved through many mechanisms, including having binary metrics and scorecards or dashboards of expected results, and measuring and reporting each business unit's performance against these standards. It is important to learn from mistakes and regularly review and strengthen existing control mechanisms.

Thirdly, it is important to have independent reporting lines into the board for the risk and audit functions. These reporting lines should extend through to the international subsidiaries.

Further, an on-going renewal process that sees bank board learning from mistakes both their own mistakes as well as others in the industry as a process of regular reviews and strengthening of existing control mechanisms. Similarly, International businesses and subsidiaries should also be reviewed to determine that they are not on strategy and should be eliminated if no longer strategic.

Lastly, the performance of the board and individual directors should be evaluated periodically, to ensure ongoing renewal, and also to ensure that the board takes a holistic perspective of its responsibilities with all stakeholders.

22. "Board and Committee Effectiveness" – Matters:

"Board Directors sit on the Audit committee, the Human Resource committee, the Risk Management committee or on the Corporate Governance committee. As a result the Directors have a higher familiarity in a particular area" - Bank CEO

Category 22 – Board and Committee Effectiveness:

Board and Committee Effectiveness					**Canadian**	**Foreign**		**Cited**
	Chairman	**Director**	**CEO**	**CRO**	**Expert**	**Expert**	**Totals:**	**%**
Total Interviewees:	**3**	**3**	**2**	**2**	**3**	**2**	15	
Made comments:	**3**	**2**	**1**	**2**	**2**	**2**	12	80%
Category:								
Effective Exchange/Decisions	7	5	5	2	1	3	23	192%
Good Information/Planning	2	4	2	1		1	10	83%
Right People / Leadership	4	4	2	4	4	1	19	158%
Good Teamwork	4	5	4	5	1	1	20	167%
Board/Committee Renewal	3	3	1	1	1		9	75%
Focus on Priorities	2	2			1	2	7	58%
Total:	22	23	14	13	8	8	88	733%
# Citations per Source:	7.3	11.5	14.0	6.5	4.0	4.0	7.3	

This last category, "Board and Committee Effectiveness" ranked #4 of 22 Categories with 88 citations. With a focus on the effective workings of the committees and the board it is again not surprising to see that bank insiders were the ones who stressed the importance of this attribute of the board in achieving good governance. The CEO's and the board directors scored the highest average number of citations with 14.0 and 11.5 respectively.

Focusing on the Effectiveness of the Board, comments offered included:

"I think the Canadian (Board) model works very well. We have a board of experienced people from outside. We have no one [executives] other than the CEO as directors – that forms a clear delineation between management on the board, and their respective responsibilities." – Bank Chairman

"So boards of a dozen [members is good]. Once you get below a dozen it gets tougher and tougher. Once you get above 16 or 17 or 18, it's starting to get too big. If you shrink beyond a certain size it becomes like management." – Bank CEO

"Part of the regulatory push is to try to get boards to almost be management. And I think that is a big mistake." – Board Director

"I think a lot of these rules-based approaches don't work. I think somebody at the [ICD conference June 7, 2011] suggested they wanted "professional directors" and I believe that is nonsense. And then someone else said they wanted everyone to have "risk expertise" – I'm sorry, all of those rules are an invitation to a variety of problems including Group Think". – Board Director

"There is always a fine line between safety and soundness, between profit and growth. Hitting that fine line is the important thing. You can be safe and sound and not have any growth." – Bank Chairman

Focusing on the Effectiveness of Committees, comments included:

"Like the Audit Committee – you need people with financial expertise on the committee, and on the risk committee and on the board it's good to have people with expertise in financial institutions and knowledge of risk matters and some knowledge of risk governance. But you don't want everybody with the same skill sets." – Board Director

"We have 10 Board meetings a year. The committee chairs are usually in ahead of the game sitting down with the staff liaison - that could be the head of risk, or the head of audit, or whatever for some advance work, preparing the agenda, getting an understanding of the issues so that they come out in the meeting and having a chance for one-on-one dialogue without having an audience there, to get a clear picture as to what's happening. So they (Committee Chairs) get a bigger load." – Bank Chairman

"I also point out that today's Board work is a material time commitment. It would be hard for me to do this on many boards. And it would be difficult to find quality directors who are not giving that kind of time commitment. Personally I'm spending a lot of time as chair of a committee and I would estimate it's taking 1/4 – 1/3 of my

time. It may be less than working full-time but it is a serious commitment." – Board Director

Three sub-categories received the highest concentration of comments. The sub-category Effective Exchange/Decisions was cited 23 times:

"They (Directors) also have different areas of interest. Board Directors sit on the Audit committee, the Human Resource committee, the Risk Management committee or the Corporate Governance committee. As a result Directors have a higher familiarity in a particular area. So that makes sure "group think" is less likely to happen". – Bank CEO

"If you have a board that has a "nose for trouble" or is good at sorting out something that Management thinks is a great idea, and it might not be, I think you have to have a "nose" for that. But I also think that you have to have fairly good processes in place, which is why we talk a lot about the need to have occasional independent reviews of how good your processes are." – Canadian Expert

"But the second thing is how do you actually get to the point where the board can intelligently and sensibly evaluate what management's key decisions are, whether it's movements into Thailand, or moving into some country in Central America, or expanding into a whole new sort of trading operations outside of Canada. I think those are really challenging issues and they will become even more challenging." – International Expert

"The decision-making process in Canada is tailored so you don't get a "freight train mentality". If the issue isn't urgent it generally takes 3 to 6 to 9 months before people on the board get their heads around it and they are not boxed into a corner by a very aggressive management team that could play a trick or put pressure on a board". – Canadian Expert

The sub-Category Good Teamwork was cited 20 times. Comments include:

"The board needs to be looking at how they can assist management, support management, challenge where appropriate but also contribute to building value. That includes having the processes, the attitudes and good relationships between board members and having an effective Chair which is hugely important. I don't think there is a lot of "rocket science" here." – Board Director

"What I see in this board is that there is no "inner board", there is no little group that knows each other well and does most of the talking." – Bank Chairman

> **"The average board member spends maybe 30 to 35 days a year on the bank's business. The front line of defense on all things is the management of the bank with the board overseeing that. So the board has to make sure that they are looking at all of the material issues but also recognize that there are limitations, given that management is immersed in the business on a full-time basis."** – Board Chairman

The sub-Category Right People/Leadership was cited 19 times. Comments include:

> **"I think if you have a good effective nonexecutive chairman, who is in tune with the other directors, and that you have executive sessions at the Board level and at the Committee level, chairs that are assessed by individual directors for their strong leadership skills and industry knowledge, there is less likelihood that management will co-opt a board and bring them down a wrong path."** – Canadian Expert

> **"We have the good fortune of being able to choose the best and the brightest across the country. Being a bank board is a prestigious appointment. People tend to say yes. And we as a bank do try to go cross country, to have diversity, and address a number of things [skills] that we are looking to accomplish, but they are all leaders in their own right or they wouldn't be asked."** – Bank Chairman

> **"It is not the role of the chairman to make the board room collegial."** – International Expert

> **"I think it's a skill of a good Chair to make sure that you get diverse points of views and an encouragement to probe in all the different areas. There is a huge difference that the Board Chair can make in making sure that you actually challenge management appropriately and that you try to make sure that some competing or alternate points of views are raised, such that you end up having a complete discussion."** – Chief Risk Officer

The primary conclusion from this category is that the Effectiveness of the Board is critical for its success in achieving good governance. Since the board gets a considerable amount of its governance work done within the board committees the board can only be effective if the committees themselves are also effective. Specific conclusions that emerge from this analysis are: 1) Although not prescriptive, there is general agreement that board size needs to be in the 12 – 15 range to allow enough Canadian residents to be a majority on each Board Committee (by Canadian bank regulation) and yet small enough to ensure effective discussions and debate; 2) Board composition is very important. Nominations committees need to seek candidates who are experienced leaders, people with professional skills, individuals who are committed to the bank's success, who have an aptitude for teamwork and can also meet the demanding time commitments (ranging from 3 days per month in one Bank's estimate case up to 8 days a months for one director who also chairs a board committee); 3) There was much endorsement across many respondents for the Canadian Model for board governance which includes the separation of CEO and the chair, a Board size of 12-15, an independent board committee structure, and following the Anglo-American model for board & management structure; and 4) Boards need to focus on governance or as one person referred to it as "safety-soundness". But boards also have to make decisions in an environment where banks make money by accepting various risks.

Table 14: Research Categories Ranked by # Citations

Research Categories Sorted by Total # of Citations:			Total	% of	Total	Avg. Per	
Rank	Thesis #	Research "Category"	Subjects	Subjects	Citations	Subject	KISS Principle
1	17	Integrated Board, Subsidiaries and Manag	15	100%	178	11.9	Integrated
2	20	Auditing and Risk Management Function	15	100%	139	9.3	Control
3	13	Focus of Strategy and Future of Internatic	15	100%	114	7.6	Strategic
4	22	Board and Committee Effectiveness	12	80%	88	7.3	Control
5	16	Targeted Development of the Board	14	93%	66	4.7	Integrated
6	11	Targeted, Diverse Board Composition	15	100%	64	4.3	Strategic
7	2	Canadian Domestic Environment	15	100%	63	4.2	Situational - External
8	21	Controlling Function of the Board	13	87%	62	4.8	Control
9	19	Effective Management and Company Cult	13	87%	62	4.7	Integrated
10	5	Breaches of Governance:	14	93%	57	4.1	Situational - External
11	15	Targeted Board Selection, Feedback and E	15	100%	54	3.6	Integrated
12	4	International Regulatory Environment	14	93%	53	3.8	Situational - External
13	12	Critical but Constructive Culture of Trust	12	80%	51	4.3	Strategic
14	1	Canadian Regulatory Environment	13	87%	45	3.5	Situational - External
15	7	Subsidiary & Main Board Configuration &	11	73%	43	3.9	Situational - Internal
16	6	Lessons Learned	12	80%	43	3.6	Situational - External
17	10	Global Integration and Local Response	9	60%	36	4.0	Situational - Internal
18	9	Organizational Complexity	12	80%	36	3.0	Situational - Internal
19	18	Good CEO (Stewardship Theory)	13	87%	32	2.5	Integrated
20	14	Effective Chair	11	73%	31	2.8	Strategic
21	8	Degree of Internationalization	9	60%	30	3.3	Situational - Internal
22	3	International Environment:	11	73%	23	2.1	Situational - External

(Source: Own Design)

Conclusions regarding the Effectiveness of Committees included: 5) the need for Board Director's to have professional expertise and available time to commit to these very serious roles. Additional reference was made to: 6) the need for diversity of views, experiences and backgrounds to endure wholesome discussion in Committees and not a room full of similar skill sets, backgrounds and views.

In the three sub-categories we also learned of the need for: 7) a "nose for trouble" which basically underscore experience, leadership and good judgment and decision making that only comes with special individuals; 8) ability to challenge management; 9) the ability to defer decision making when board directors are not yet certain and management has not forced the issue before its time; 10) an environment that "works with management" in a fashion that engenders the spirit of "trust yet verify"; and 11) carefully selecting the right people as directors and in choosing a board chair. Leaders who have the attributes and skills that enable debate, yet can bring closure when needed; people who can demonstrate commitment to fellow board directors and can assist management as they work to achieve the company's objectives for the benefit of all stakeholders.
Table 14 "Research Categories ranks by # Citations" provides a summary of the results that interviewees attributed to each of the 22 research Categories.

Conducting Effective Board Meetings:

One of the most important mechanisms for an effective Board is how the actual Board meetings are conducted. Canadian Banks tend to schedule 10 regular Board meetings throughout the year, plus one offsite for strategic planning and Board development. The methodology for conducting regular Board meetings appears to follow a similar formula across all of the banks. One Chairman took the time to explain the formula his bank follows. Before leaving this Category on Effective Boards and Effective Committees I believe this formula for Board Meetings would be of interest to readers. The board chair provided the following comments on how to structure an effective Board Meeting:

> **"We divide our meetings into two days: Day 1 is all committee meetings, because we delegate a lot of the detailed stuff out of the Board to make time for big picture things at the board – so, Risk committee, Audit committee, HR committee meet for half a day minimum each and sometimes longer, the day before the board meeting. Then we have a dinner, and dinner discussions are always business except for once a year when it is social.**

> **Day 2 the board meeting is divided into three periods over 6 hours: the first two hours are spent in-camera with the CEO, no management a full discussion; the second hour is either on strategy or on talent, like succession and development of key individuals, no business other than that. The second period is operational – we bring in all the management and we go through the business units and how they did - they are only allowed three charts: how they did in the quarter, what their issues are, and what their opportunities are. This is the standard format and they can't fudge it. And they are not allowed to pitch it. Everyone on the board has read the materials – The presenters normally get 20 minutes each and they can talk for up to 10 minutes, but we encourage less and the rest is discussion.**
>
> **The third period is where all the committee reports are. Because we have delegated so much to the committees, we then need to give the committee chairs, plus their management executive contact (the Chief Risk Officer, the Chief Financial Officer for Audit, the Chief HR Officer for the HR Committee), the chance to spend in-depth time with the rest of the board to explain what's going on in their area.**
>
> **From time to time we will put on other presentations and that third period, like a staff function or IT or something like that. Period 1 is always the board only, although, if it's strategy we might bring in the chief strategy officer in, or we are going to do an acquisition, the head of that business unit, but it's not full management except for maybe two or three, plus the CEO in the room. The line mangers are in period 2. In the 3rd period we would also look at stress tests, liquidity and those kinds of things."**

3.6 Conclusions from the specific theoretical part

> **"I believe that banking institutions are more dangerous to our liberties than standing armies." –** Thomas Jefferson (1743 - 1826), (Attributed)

This quotation, attributed to the third president of the United States, gives an interesting insight into the effect felt that banks and banking systems played on the lives of citizens.

Today with the unprecedented levels of unemployment we are seeing in many countries and the stresses we are seeing on the European community including a potential threat to the euro, we are reminded of Jefferson's warning. In June 2012 at a meeting of the G20 in Los Cabos, Mexico, to discuss among other matters the financial crisis in Europe, the President of the European Commission, Jose Manuel Barroso, lashed out at the North Americans who were lecturing Europe to resolve its problems of fiscal instability, by reminding his audience that "the global economic crisis of 2008 began in North America due to some 'unorthodox' practices by the financial sector"[266]. With the 2008 banking crisis and the subsequent contagion into Europe should we be wondering whether a contagion of the global banking system is now more dangerous to our liberties than standing armies of the world, as Jefferson foretold?

The term *contagion* has recently been added to our lexicon. A global economic threat brought on through contagion of the international banking network is all the more reason to redouble our efforts to achieve good governance in our international banks and their subsidiaries.

The Canadian banks I examined above bring forward many important observations and conclusions for consideration by international and global banks.

First, to achieve good governance in their international subsidiaries, banks must have in place strong and effective governance mechanisms in both their domestic and head office environments. If good governance is not occurring at home, bad practices will undoubtedly eventually spread into the international subsidiaries. If good governance is occurring at home, there is an opportunity to extend these practices to the international subsidiaries.

I present my conclusions below, under "Good Governance Practices in Canada's Banks," and "Good Governance Practices in International Subsidiaries of Canada's Banks." These findings are based on the weightings provided by my interviewees as expressed in the above analysis of the twenty-two categories and are presented in Hilb's "Reversed KISS" format. To view the complete list of the 114 subcategories that structured my analysis and conclusions listed above, see Appendix 13: *Research Sub-Categories in Priority Order*.

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[266] Montreal Gazette, June 18, 2012 – See:
http://www.montrealgazette.com/business/Europe+snaps+back+Harper+over+lecture+debt+crisis/6801657/story.html

Good Governance Practices in Canada's Banks:

Keep it Situational in Canada:

1. Regulators play an important role in the success of Canada's Banks.

   - The Canadian bank regulator (OSFI) is seen as being proactive in supervising Canada's banks. They follow a trust but verify approach. They are viewed as being open to discussion and flexible in how they achieve their supervisory and regulatory aims. This works well in Canada's culture and banking framework.
   - Canada had implemented the Basel II framework for capital and that helped the Canadian banks ease through the 2008 financial crisis.
   - The separation of board chair and CEO is recognized as a necessity for successful governance of the banks.
   - Pressure from the regulator to create Risk Appetite introduced a whole new way of thinking about, measuring, communicating, testing and approving risks in banks.
   - Canada's system for mortgages (bank retained asset, 10% down payments, retained liability of the borrower, no income tax deduction, etc.) was seen as critical to surviving the 2008 mortgage crisis in the US
   - Interviewees referenced other pressures from regulators plus regular meetings from OSFI with banks and boards. This creates a healthy understanding and dialogue that helped both the banks and the regulators in being more effective in their respective roles.
   - Strong supervision matters.
   - The relationship between the regulator and the banks is particularly effective in Canada where the banks are few, large and diversified and easier for the regulator to get to know and understand each bank in greater detail.

2. Breaches of Governance and Lessons Learned play important roles in the success of Canada's Banks

   - Breakdowns of governance, frauds and other breaches of governance all occurred in these five banks and these events play a valuable role in the evolution of good governance practices in the Canadian banks. While Canada's banks demonstrate a strong desire to strive for best practices, every bank had used their breach to tighten up existing processes, introduce new practices and expand on training and communication to employees and management. They turned each negative event into a positive opportunity.

- Similarly Lessons Learned plays an important role in these banks improving their own processes and to increase levels of knowledge and efforts around "good governance". Lessons are learned from both inside each bank and by carefully monitoring other industry incidents. All banks admitted to carefully examining governance breakdowns both in Canada as well as outside of Canada (Société Générale, ENRON, etc.) to explore that they have the necessary controls to ensure that those issues could not occur in their own banks.
- Publicly reported crises in the industry provide Directors a risk-free opportunity for personal development by turning some other bank's misfortunes into and a "case" to first seek understanding and secondly comfort from risk and management on their own bank's controls and processes.

3. The domestic and the international environments play an important role in these banks achieving good governance.

- While these banks do display a healthy attitude for good governance and have developed effective techniques, there was also general agreement that factors outside of their direct control helped them achieve the stable earnings they have enjoyed.
- The regulatory environment played a major role, but so did Canada's healthy economy at the time of 2008 financial crisis. Many bankers attributed some of this success to good conditions.
- Similarly, many interviewees referenced the groundswell of change in Canada for improved governance that came out of industry associations and industry watchdogs, such as the Canadian Coalition for Good Governances, the Institute of Corporate Directors, the Clarkson Centre for Board Effectiveness, and the *Globe and Mail*'s governance-monitoring *Board Games*.

Keep it <u>Strategic</u> in Canada:

4. A strong focus on strategy, strategic issues and execution of strategy helps Canadian banks and their boards achieve "good governance" as well as stable and sustainable results.

   - Where these 5 banks differ the greatest is in their international strategies. These strategies contribute revenues from 15% to 40% of the banks' bottom lines. The strategies vary from "having more branches in the US than in Canada" to being "the largest retail bank in Latin America and the Caribbean" to being "a respected global Capital Markets player".
   - Focusing on these strategies and being consistent with these strategies has been fundamental to their unique successes.
   - Keeping the international strategy consistent with the overall and domestic strategies is also critical for their success in achieving good governance.

5. Constructive engagement at the board within a culture of trust between the board and management helps both management and the board achieve their business goals and responsibilities for good governance.

   - As important as a skills matrix is in leading to an effective board, a recurring message from both management and board members is that for a board to be effective, the board and management needs to operate in an environment of mutual respect. Management has clear operating objectives. The board has clear responsibility for oversight. There will be times when these responsibilities conflict. In spite of these differences a culture of trust and respect must endure.
   - That respect must allow for and encourage constructive engagement at the board level. Constructive engagement at the board plays an important role in achieving good decisions and good governance in the Canadian banks.
   - A culture of trust and respect also must be in place in the board committees where detailed work is delegated from the board and where gaps in director information and understanding might be its widest.

6. Targeted selection, demographics, skills and experiences of board directors make bank boards effective in achieving good governance

- Canadian banks and their boards require an interesting mix of professional skills (risk, finance, legal, etc.) and diversity (geographic, gender, etc.). However the one common denominator is they are all seek proven, successful business leaders, who as one Canadian expert expressed it, have a “nose for trouble”.
- All banks discussed having a defined competency or skills matrix for their board reviews and being very targeted in director selection based on skills.
- While all boards follow a skills matrix, they all strongly argued that effective boards cannot be built following a prescription of director skills, or by crafting a specific size for their Board. Effective Boards combine a variety of the variables presented below. Flexibility is needed in director selection to achieve success.
- Another common denominator is the amount of time each Director must dedicate to bank business ranging from 3 to 8 days a month.

7. Independent chairs who artfully facilitate board engagement and move discussions to decisions are central to establishing effective Boards in Canada’s banks.

   - There was unanimous agreement that the roles of the CEO and chair needed to be split and that the chair needed to be an independent director. There was also general acknowledgement that this transition in Canada took effort.
   - Selection of the board chair is a critical responsibility for the nominations committee and the board. Banking skills are not a prerequisite. Effective chairs were seen to be experienced charismatic leaders who are good business people, good facilitators, good communicators and good with people. They set tone from the top.

Keep it <u>Integrated</u> in Canada:

8. Canada’s banks demonstrate respect for the different responsibilities between the Board and Management, and develop a culture of trust to achieve good governance as well as strong and sustainable financial results.

- Cited extensively these banks discussed the interaction between management and the board and the committees as being a relationship. One director referred to it as an excellent relationship of trust. This integrated approach occurring within the Board and operating in the board's committees helps to generate good governance.
- One negative situation was mentioned several times by different banks, where board integration was not happening and has been problematic. The gap was between the main board and their subsidiary boards in the United States. One interviewee complained that that subsidiary boards in the United States did not own responsibility for financial performance of the subsidiary. They saw their responsibility ending at governance of the subsidiary only. Another interviewee complained that their U.S. subsidiary board of which he was a director did not provide requested information for several years. A third interviewee wished he could replace the U.S. board with management. Another interviewee indicated that his bank needed to replace the entire U.S. subsidiary board for targeted selection of new subsidiary directors who could work in an integrated fashion meeting the needs of the U.S. regulator as well as the Canadian parent. There are several successful Canadian banks in the United States. The U.S. regulators stress that U.S. directors must focus exclusively on the needs of the US subsidiary. This goal needs to be carefully integrated with the overall needs of the main board.

9. Governance does not solely rest at the board level. In Canada's banks governance is incorporated throughout these banks.

   - These banks have worked successfully at creating enterprise-wide standards. These standards that reflect the board's global requirements of the entire franchise must be in effected in every location. Examples include a universal code of conduct. Others include risk appetite and whistle-blower policies. These standards all contribute to good governance in these bank subsidiaries and also contribute to global effectiveness.

10. Board development and renewal plays an important role in keeping the board effective and current as changes occur in the environment and the industry.

- These banks have all accepted the need for periodic renewal of their boards. Early in the evolution of corporate governance, Canadian banks were among the 1st to split the roles of CEO and the chair. Bank boards decreased in size from roughly 30 directors to the current range of 13-17 directors. Shortly thereafter the Canadian banks introduced the independence of chief risk officers. More recently these boards have moved for additional risk and financial expertise on the boards as well as increased diversity. These periodic reviews happen more regularly. The term Board Renewal is well a understood and used term in these banks.
- All banks have undergone formal third-party governance reviews from firms like McKinsey or Oliver Wyman. Canada's regulator is in the early stages of suggesting that this review process become a triennial event for all banks.
- Targeted Development of Directors is now a formal initiative, though banks take different approaches to these learning opportunities. One expert chastised directors in Canada for not being current with social media. Director development will continue to be important challenge for these banks, looking forward both for the main board as well as subsidiary boards.

11. Canada's banks demonstrate strong teamwork both in the board and in management.

- Being appointed to a bank board in Canada is quite prestigious. These boards all have comprehensive evaluation and feedback mechanisms on individual directors. The individuals are chosen for being well respected and successful leaders in their fields, and none would be comfortable in receiving a poor performance rating or in being asked to leave the board due to performance issues. As a result, Canadian board directors are a motivated group who work well as a team and work hard to not disappoint their peers on the board.
- Teamwork across the board and management is most evident in the board committees (risk, audit, HR and governance). Comprehensive work is conducted in the board committees. Good teamwork between the directors and management is a crucial ingredient in generating good governance.

- Finally at the board itself, we have already established the culture of constructive debate, a culture of trust and the respect that exists. Although the objectives of management and the board may be somewhat different, this culture of respect and trust allows for good integrated teamwork and good governance.

Keep it Controlled in Canada:

12. Effective and evolving risk management practices plays a critical role in the success of Canadian banks achieving good governance.

    - This is the #1 finding of my research.
    - Targeted selection of the chair of the risk committee and the chief risk officer are keys to success of the risk function, the risk culture and for these bank to achieve good governance practices.
    - Ensuring a duality of risk reporting lines throughout the entire domestic and international operations provides independence of thought and a second set of eyes throughout the entire organization, and in particular into the international subsidiaries of these banks.
    - Global effectiveness requires consistent risk standards and processes across the enterprise and into the international subsidiaries. This often included interlocking risk committees between the international subsidiary and the main board committees.
    - Crafting, managing and evolving risk tools are of paramount importance to the success of the risk function in these banks. These tools and metrics include: measures for risk sizing including board approved and published Enterprise-wide risk appetite limits; processes and techniques for testing risk, including stress testing and scenario testing; clear enterprise-wide guidelines for acceptable (in-strategy) risks and a clear understanding of acceptable trade-offs between risk and returns.

13. Effective controls in the Canadian banks plays an important role in achieving good governance, in particular the audit and risk management functions of the board.

- Auditing and the Risk Management function of the Board rated as the second most important category in my research. The category Controlling Function of the Board ranked eight most important of the 22 Categories. These control functions are critically important for good governance.
- The independent reporting lines of the chief risk officer and the chief auditor or CFO to the board's risk and audit committees respectively, provides an opportunity and a structure of transparency and openness between the board and key executives who hold responsibility for these critical governance functions.
- Holding in-camera sessions at every board meeting was highlighted by many Board members and Chief Risk Officers as being important for the overall health of these banks. In-camera sessions are most effective when they are led by an independent chair.
- A disciplined and structured audit programme adds tremendous reach and understanding to the goal of good governance. While one board chair referred to the discovery of an internal fraud during a routine audit, most bank insiders saw the benefit of audit as a control mechanism to detect early warning signs in international areas that might be declining in operational health. With a view of looking backwards at what has already occurred in the banks, the audit function is very complimentary to the risk function which is described as looking forward to examine what might happen.
- Separating the risk committee and function from the audit committee helps to increase good governance practices and decisions in these banks. Strong central financial controls, segregation of duties, completing Codes of Conduct and other similar hard controls are critical for governance success. Similarly, soft controls such as a strong company culture, corporate Mission Statements and Company Vision are equally critical for communicating expectations and setting tone from the top to ensure good governance behaviours in these banks and their international subsidiaries.

Figure 12 on the next page summarizes my conclusions on good governance Practices in Canada's Banks, with particular focus on the main board.

Figure 12: Good Governance Practices in Canada's Banks

Good Governance Practices in Canada's Banks:
Keep it <u>Situational</u> in Canada: 1. Regulators play an important role in the success of Canada's Banks. 2. Breaches of Governance and Lessons Learned play important roles in the success of Canada's Banks 3. Both the Domestic Environment and the International Environment plays an important role in these banks achieving good governance. **Keep it <u>Strategic</u> in Canada:** 4. A focus on Strategy, Strategic Issues and Execution of Strategy helps the boards of Canadian bank achieve good governance as well as stable and sustainable results. 5. Constructive Engagement at the Board within a culture of Trust between the Board and Management helps both Management and the Board achieve their business goals and responsibilities for good governance. 6. Targeted Selection, Demographics, Skills and Experiences of Board Directors make these bank Boards effective in achieving good governance. 7. Independent Chairs who artfully facilitate board engagement and move discussions to decisions are central to establishing effective Boards in Canada's banks. **Keep it Integrated in Canada:** 8. Canada's banks demonstrate respect for the different responsibilities between the Board and Management, and develop a culture of trust to achieve good governance as well as strong and sustainable financial results. 9. Governance is not solely at the Board level. In Canada's banks governance is incorporated throughout these banks. 10. Board Development and Renewal plays an important role in keeping the Board effective and current as changes occur in the environment and the industry. 11. Canada's banks demonstrate strong teamwork both in the Board and in Management. **Keep it Controlled in Canada:** 12. Evolving Risk Management practices plays a critical role in the success of Canadian banks achieving good governance. 13. Ensuring effective controls in Canadian banks plays a critical role in achieving good governance, in particular the Audit and Risk Management functions of the Board.

(Source: Own Design)

Now that we have examined how these Canadian banks generate good governance practices and processes, in the next section I turn our attention to how these banks ensure good governance practices and process are actively in place in their international subsidiaries.

Good Governance in International Subsidiaries of Canada's Banks:

Keep it <u>Situational</u> in Subsidiaries:

1. Canada's banks understand and manage the challenges of integrating international subsidiaries into their regulatory, systemic, and operational frameworks.

    - By accepting the business opportunities that international operations provide, these banks are also accepting the challenges they create. With the rapid pace of regulatory changes over the past decade the challenges to stay current have been immense. Coupled with the fact that there is no universal set of rules, banks like these Canadian banks are forced to comply with not only different set of rules, but also different interpretations of the same rules by different countries.
    - These variants also create regulatory arbitrage and competitive differences for these international banks that are competing with other international banks. As we saw, Canada's regulator forced banks to implemented Basel II whereas the US banks were not required to. Though this had a positive effect during the 2008 banking crisis, before that crisis hit the US banks had a lower cost of capital base and were more competitive in their pricing of products. Regulatory arbitrage as one Executive coined it, is a real challenge for these banks.
    - Another challenge was seen recently in the methodology European Central banks followed with their banks in the pricing of sovereign debt during the European crisis. It was stated by several interviewees that if the Canadian regulator were in the same circumstance that Canadian banks would have been forced to mark-to-market those financial instruments and to record the financial consequences.
    - Another challenge was offered by an international expert who felt that the culture in the Canadian banks was not conducive to the brutal competition

that occurs in the US. Some banks have been successful in the US while many others have withdrawn.

2. The International Regulatory Environment significantly affects the way these banks do business.

    - The international regulatory environment was seen by an overwhelming majority of those interviewed as the single biggest challenge facing international banks in the future, including these Canadian banks.
    - This is resulting in Canadian banks altering their structures and processes. As one bank chair said: “it’s no longer sufficient for us to manage risk in our European subsidiary from Canada. We now have a chief risk officer there”.
    - These banks are required to stay current with the proposed new changes including new rules for Basel III, changes for the Dodd-Frank Act, requirements for Living Wills that will affect strategies for international subsidiaries, as well as the proposed changes at the UK’s FSA, among other proposed changes. These new regulations could well affect strategies and tactics regarding the banks international subsidiaries

3. Effective Subsidiary and Main Board Configuration contributes to good Governance.

    - As stated previously a recurring theme for Canadian banks with material subsidiaries in the US is the recognized frustration that the US regulator does not take a holistic view of the US subsidiary and chooses to ignore the role and the work performed by the Canadian parent company. The regulator insists that US subsidiary directors not be directed by a foreign parent. As one Chairman said the US directors feel responsible for governance but show no responsibility for financial results. In conflict is the Canadian regulator who insists that Canada’s banks cannot delegate responsibility for any subsidiary. That creates duplication of effort for Canadian banks that operate subsidiaries in the United States. This is an interesting case to follow for further examination, and could be problematic as the US often sets practices that other countries follow.

- Integrating foreign directors onto the Main Board has challenges and benefits. One bank has successfully integrated two international (neither US nor Canadian) directors into their main board and saw the benefits in discussion and decision making. Another bank once had a UK director on the main board but with the increased workloads on Directors in Committees that did not work successfully. Many interviewees and in particular the Experts Groups, saw a day when the addition of international directors will be a necessity. Current residency rules in Canadian bank boards and committees may need to be amended if board size it to remain where it is currently.
- Many respondents recognized that the relationship between the main board and the subsidiary board is still evolving. Especially as the international presence of these banks grow, the importance of the international subsidiaries will also grow and changes to subsidiary board make-up will be an even increasing requirement. One executive wondered whether a regional governance structure might be the next major evolution.
- All banks had subsidiary board guidelines, typically located in the bank's corporate secretarial office. One bank has a fully staffed and globally located subsidiary governance office headed by a bank vice president.

Keep it <u>Strategic</u> in Subsidiaries:

4. Canada's banks follow strict disciplines to ensure their international subsidiaries are consistent with overall bank strategy.

- Every bank talked about international expansion as being strategically important for the future of their bank. It was also stressed that international subsidiaries needed to be consistent with the bank's competencies, products and branding (e.g. retail domestic banking).
- One bank followed an expansion process of taking a position in a new market for a few years, often through a joint venture, to obtain direct experience in that market before expanding into a wholly owned subsidiary.

- Several banks also described withdrawing from certain markets when it was determined that these subsidiaries and these markets were no longer seen as being consistent with the bank's overall strategy.

5. Governance in the international subsidiaries is of strategic importance to these Canadian banks.

   - All banks are active in seeking opportunities to integrate the main and subsidiary boards through interlocking board memberships for strategic subsidiaries, or via management for other substantial subsidiaries.
   - Looking forward, all of Canada's banks see their international strategies as playing an increasingly important role in their bank's future growth.
   - These banks recognize that as their international presence expands and takes on increasing importance to their bank, changes will be required in the governance processes as well as perhaps even their board and subsidiary board make-up.
   - Seeking and obtaining international skills helps these Canadian banks and their boards achieve good governance in their international subsidiaries both in their main board as well as in their subsidiary boards.
   - Canadian banks see their international strategies as a component of the bank's risk diversification strategy for stability as well as growth.

Keep it <u>Integrated</u> in Subsidiaries:

6. Canada's banks have developed effective mechanisms and policies that allow international subsidiaries to operate effectively in their local markets, but are integrated to the global requirements of these banks, including good governance.

   - Effective mechanisms include each bank's Enterprise-wide Standards that provide specific (hard) guidance on behavioural expectations of the bank for all subsidiaries and employees. Examples include the need for all employees to understand and complete the bank's Code of Conduct, Privacy Policies, Anti-money Laundering Policies and the banks' Whistle-blower Policies. They are all related to governance issues that permeate through these banks. We reference these standards as components of Global Effectiveness.

- Experienced bank employees play a critical role in the integration of international subsidiaries. All banks mentioned the need to have "experienced" bank officials located in these international subsidiaries. They might not be in the top management role, but they would be individuals who are familiar with the financial, risk, audit and systems processes within each bank and would also be representatives and carriers of the banks' unique cultures. These Link Pins (Hofstede) working with experienced Bi-Cultural Managers (Hofstede) serve as the intermediaries to allow Global Effectiveness and Local Responsiveness.
- Effective processes and policies include internal audit visitations, defining and measuring risk appetite, as well as policies and procedures for Subsidiary governance processes and materials for subsidiary directors,

7. Corporate Governance in international subsidiaries is actively managed and integrated with the Subsidiary boards to achieve good governance in international subsidiaries.

- These banks carefully review their international subsidiaries to evaluate the optimal approach for selecting Management. Banks with more experience and more extensive and complex international networks focus on selecting and training local management, for improved Local Effectiveness.
- Similarly these banks carefully review the dynamics of the board to ensure that subsidiary boards are effectively structured and that subsidiary directors are carefully selected. Their approaches align closely with the theories discussed earlier that take into consideration: the stage of development of the subsidiary (Molloy); the degree of freedom needed in the subsidiary (Hilb); the need for an active Board (Du); the need for strategic governance (Kiel & Rich); the Degree of internationalization in the bank (Hilb); and the need for competing in the local markets (Kiel).
- Though expressed in different ways, each bank followed its own methodology to determine the optimal structure and composition of each subsidiary board. One bank classified each of their subsidiaries into one of four risk-based categories and that classification provided them a pre-

designed framework for designing the subsidiary boards and in targeting subsidiary directors.

- In all cases there is an independent risk officer in each subsidiary who reviews all material activities in the international subsidiary and who has an independent reporting line into the chief risk officer who reports to the main Board.
- The more experienced international banks relocate subsidiary managers to their Corporate Headquarters for significant periods of time (2-3 years) to obtain the contacts, familiarity and culture necessary to be a successful leader in returning to their home country.

8. Company culture plays a key role in achieving good governance in the Canadian banks international subsidiaries

- A recurring observation in my research was the critical role that culture plays in uniting international subsidiaries into a single global enterprise. In addition much emphasis was also placed on company vision and other soft controls. These are key ingredients for success as they are they are principles-based and are seen to be very useful in providing guidance for questions or occasions where internal manuals have not provided specific directions or instructions.
- Recognizing the increased complexities of operating subsidiaries in foreign jurisdiction mechanisms such as culture, values and principles are valuable tools for the board to ensure good governance is occurring in their international subsidiaries.

Keep it <u>Controlled</u> in Subsidiaries:

9. Good controls leads to good governance in international subsidiaries.

- A regular audit programme to international subsidiaries adds tremendous reach and understanding to the goal of good governance. Banks benefit from audit as a control mechanism to detect early warning signs in international subsidiaries that might be declining in operational health.
- Ensuring compliance with enterprise-wide standards including compliance with financial controls, segregation of duties, ensuring all employees are

up to date in completing their Code of Conduct examinations are important hard controls that apply to international subsidiaries. Soft controls may be even more important to ensure consistency of a global franchise as banks cross cultural boundaries. Soft controls include ensuring that the bank's unique company culture is operating within these international subsidiaries.

10. Comprehensive Risk Management and Risk Measurement techniques lead to good governance in international subsidiaries.

- Separate risk officers located in each international subsidiary overseeing the day to day activities and reporting independently to the chief risk officer's team centrally is important for good governance in international subsidiaries.
- An important risk management practice for international subsidiaries is ensuring that the international subsidiaries are strategically aligned to the company's overall objectives. If not withdraw. Several of these banks indicated withdrawing from subsidiaries that were deemed to be no longer on-strategy.
- Global Effectiveness requires consistent risk standards and processes are operating across the enterprise and in the international subsidiaries. This often included interlocking memberships on risk committees between significant international subsidiaries or holding companies and the main board committees.
- Ensuring compliance with all risk measurement policies and practices is of paramount importance to the success of the international subsidiaries.
- Subsidiary management plays a critical role in ensuring the subsidiary is operating in a fashion consistent with the letter and intention of the bank's overall strategy. One effective control mechanism is the use of linking-pins (Hofstede) in subsidiaries, usually expatriates who can ensure that company processes and culture is effectively operating in the international subsidiaries.
- Subsidiary boards require special attention to ensure that subsidiary directors have clear direction from the parent banks and are performing their subsidiary governance duties properly within the overall strategy of

the international subsidiary. Escalation processes are required as well as a facility to seek support and clarification from the head office.

- Banks with numerous international subsidiaries need to have well established policies and frameworks for the creation of subsidiary boards. Not all international subsidiaries require Local Effectiveness and not all international subsidiaries require independent directors. Regulations will be different by jurisdiction.
- There is a strong bias among these Canadian bankers for the Canadian model of board make-up and governance. Interconnectivity with the main Canadian board and its directors and integration with the Canadian Board model is important for driving success in their international subsidiaries.

Figure 13: Good Governance in International Subsidiaries of Canada's Banks

Good Governance Practices in International Subsidiaries of Canada's Banks:
Keep it Situational in Subsidiaries: 1. Canada's banks understand and manage the challenges of integrating international subsidiaries into their regulatory, systemic, and operational frameworks. 2. The International Regulatory Environment significantly affects the way these banks do business. 3. Effective Subsidiary and Main Board Configuration contributes to good governance. **Keep it Strategic in Subsidiaries:** 4. Canada's Banks follow strict disciplines to ensure their international subsidiaries are consistent with overall Bank strategy. 5. Governance in the international subsidiaries is of strategic importance to Canadian banks. **Keep it Integrated in Subsidiaries:** 6. Canada's banks have developed effective mechanisms and policies that allow international subsidiaries to operate effectively in their local markets, but are integrated to the global requirements of these banks, including good governance. 7. Corporate Governance in international subsidiaries is actively managed and integrated with the Subsidiary boards to achieve "good governance" in international subsidiaries. 8. Company culture plays a key role in achieving good governance in the Canadian Banks international subsidiaries. **Keep it Controlled in Subsidiaries:** 9. Good Controls lead to good governance in international subsidiaries. 10. Comprehensive Risk Management and Risk Measurement techniques lead to good governance in international subsidiaries. 11. Subsidiary Management and Subsidiary Boards play active and critical roles in achieving good governance in international subsidiaries.

(Source: Own design)

- "Puppet Boards" are inherent dangers to achieving good governance in international subsidiaries. Banks need to ensure that there is true governance occurring in their international subsidiaries. If international subsidiary boards become perfunctory to the whims of management, governance controls can be lost. Puppet Boards expose banks to the same dangers that ENRON faced with their special purpose vehicles in Cayman where their subsidiary boards were led by rogue executives, intent on fraudulent activities. Similar breaches of governance occurred in the cases of AIG (Bermuda) and Parmalat (Cayman) where Puppet Boards were in effect. During my research I saw no signs of this within the Big 5 Canadian banks, however my work would be incomplete without adding a note of caution in this section on Subsidiary Board Control.

Figure 13 on the previous page summarizes my conclusions on "Good Governance Practices in the International Subsidiaries of Canada's Banks.

This ends Part III - Specific Empirical Section. I now turn my attention to Part IV – Concluding Section.

Part IV: Concluding Section:

4.1 Conclusions on the Direction and Control of Subsidiaries of International Canadian Banks

The clearest conclusion from this research is the degree of complexity that going international adds to the responsibilities of both management and the board. Achieving effective governance brings into play multiple situational factors and institutional actors, which explains why there is no single template or model being used across these banks for achieving good governance. Instead, effective governance stems from a series of processes, principles, and attitudes. Canada's banks have historically achieved good governance in their international subsidiaries by paying close attention to the internal and external situational factors that these banks and their subsidiaries are operating within. They have also ensured that the purpose and mandate of subsidiaries were clearly on-strategy with the rest of the corporation, so that all units are operating in an integrated fashion. The boards of Canadian banks were also shown to take a holistic approach for ensuring effective controls that generate and monitor governance as well as governance awareness among all employees.

4.1.1 Canada's International Banks "Keep it Situational"

Canada's banks have learned to pay close attention to their internal and external realities in which their subsidiaries operate. For example, they stay in close contact with their domestic and international regulators and ensure effective lines of communication are in place. Similarly, although each bank is very different, each has adapted their international presence to be consistent with their own competencies, histories, experiences, and operating environments. These banks keep it situational by running their international subsidiaries in a manner that is consistent with situational realities and organizational capabilities.

4.1.2 Canada's International Banks "Keep it Strategic"

Domestically these banks can appear to be quite similar, as they compete directly for banking accounts, ATM services, mortgages, loans, and credit cards. However, when we examine their international holdings and subsidiaries, Canada's banks are seen to be vastly different. Scotiabank for instance, is recognised by the other Canadian banks as being the most international of the Big 5. Scotiabank opened its first international presence in 1885 and since that time has established itself in South, Central and Latin America and the Caribbean to become the largest retail banking presence in this region of the world. Scotiabank continues to follow a strategy of expansion in emerging markets where they have proven success. RBC, on the other hand, is Canada's largest bank by market capitalization and it has developed a respectable reputation for international retail banking that dates back to 1882 when it first opened operations in Bermuda. In more recent times, RBC expanded its domestic and international strengths in through the acquisitions of Dominion Securities in 1988 and Royal Trust in 1993, respectively Canada's largest capital markets firm and Canada's largest private bank at the time. Those competencies have helped shape RBC's success in international capital markets and wealth management. Finally, TD Bank's acquisition of Canada Trust in 2000 greatly expanded its international ambitions and capabilities; with a strategy to focus its international efforts on developing a strong North American platform, TD-Canada trust now claims to have more branches in the United States than in Canada. These banks have been successful internationally by focusing on their strategies and their core competencies. The focus on strategy is reinforced when they withdraw from countries where an international subsidiary is deemed to be no longer on strategy with the organization as a whole. As we saw earlier, for example, TD Bank withdrew from Greece, Ireland, and Australia. The Big 5 banks thus keep it strategic by opening, keeping and expanding their international subsidiaries to be consistent with overall bank strategy and skill.

4.1.3 Canada's International Banks "Keep it Integrated"

Board renewal was a very common theme throughout my interviews. Each of these banks seeks excellence and they are competitive with each other in staying ahead of the curve on governance matters. Learning from each other and from the mistakes of others who have experienced breaches of governance is common and important for these banks and leads to regular reviews of governance matters and ultimately board renewal For example, the Big 5 banks have all developed sophisticated processes for board selection (based on skills matrices) and director evaluation and development. These institutions were also among the first to split the CEO and chair roles over a decade ago and they were among the first to separate the risk and audit components of their businesses, and gave each of them independent reporting lines to the board. Integration with international subsidiaries was shown to be conducted through a sophisticated and complex series of processes and policies including enterprise-wide standards, intraboard memberships, company culture, and link-pin managers. These banks subsequently keep it integrated by ensuring that the continuous improvement made in their governance practices extends to their international subsidiaries.

4.1.4 Canada's International Banks "Keep it Controlled"

Directly emanating from the board of directors and the board's committees, the banks I researched have all developed sophisticated and active mechanisms for ensuring effective controls in their banks and in their international subsidiaries. The chief risk officer and chief auditor report into board committees, for instance, allowing for transparency, a free-flow of information and development and communication between the board and these critically important controlling functions. Attention to Risk Management is a mature and sophisticated process in these banks including the development of sophisticated risk measurement techniques, including risk appetite, risk measurement and stress testing techniques that directly contributed to improved communications and monitoring of these banks and their international subsidiaries. Similarly manner, having independent risk officers in all international subsidiaries provides an unbiased degree of oversight into external operations. Boards pay high levels of attention to these key control functions because they provide consistency and important information into every department and subsidiary.

The Big 5 banks do not follow a single model for structuring their subsidiary boards. They each approach their subsidiary needs on an individualistic basis which reinforces the precepts identified earlier by Kiel, Du, and Hilb in the development and structure of subsidiary boards. Depending on circumstance, main board directors, senior executives, independent risk officers, and local executives from other divisions will be appointed to subsidiary boards in order to reduce or eliminate concerns about puppet boards which have proven to be hazardous in several of the governance breaches cited earlier. As a result, these banks keep it controlled by ensuring good governance is continually in place and evolving in their international subsidiaries.

4.2 Theoretical Implications

4.2.1 Implications on Theory

In focusing on the structure and function of the board of directors and the mechanisms that are in play to ensure good governance in international subsidiaries, my research ultimately supports the conclusions of Kriger, Kim, Gillies & Dickinson, Kiel, Du and Hilb. That said, my analysis did not investigate international subsidiaries themselves or the makeup and activities of subsidiary boards, as Kriger did. Although my research was conducted from a top-down perspective my conclusions agree with Kriger that the subsidiary boards play a useful role for these Canadian banks, including being a value-added tool in local markets. However my research did not support the conclusion that the role of subsidiary boards is increasing as Kriger claims. While I certainly observed that the organizational environment is changing relative to subsidiary governance, the changes are themselves consistent with new regulations and the evolving governance practices of banks in general.

Consistent with Kiel and Hilb's findings discussed earlier, I concluded that the structure of a subsidiary board will vary relative to the strategic role individual subsidiaries play in the overall portfolio of these international banks. In the United States and the UK, for example, boards are very sophisticated, with senior and often parent-level representation on these subsidiary boards. And although my research did not conclude that the roles of subsidiary boards were increasing simply as a matter of principle, my research did disclose some frustration regarding the behaviour of many U.S. subsidiary boards who are required by U.S. regulators to actively demonstrate governance control over the subsidiary, but who may not necessarily exhibit responsibility to the parent organization for financial performance. Similarly, my conclusions also support Kiel and Hilb's findings regarding Strategies for Entering and Competing internationally (Kiel), the Degree of Internationalization (Hilb), Subsidiary Degree of Freedom (Hilb) and Governance Options for International Subsidiary Boards (Kiel).

My research did not observe anything that would challenge the conclusions of Gillies and Dickinson, who were *not* able to prove that: (a) the composition of boards of large transnationals is likely to be substantially different from that of national firms; (b) boards of transnationals will take a leadership role in dealing with the social and economic issues that transcend national boundaries; (c) boards of subsidiaries of transnational firms are playing an increasing role in the general operations of transnationals; and Boards of transnationals will show a larger concern for stakeholders than boards of national firms.

My conclusions did endorse Luo's (2005) findings (See Section 1.1.2) that the degree of globalization, foreign adaptation, global competition, and international experience influenced the presence of governance mechanisms in banks such as "board size, composition, ownership concentration, and duality as well as accountability systems."1 My findings also supported Luo's conclusions that: (a) weak boards and poor independent judgement has led to corporate governance problems in subsidiaries (AIG/Gen Re.); (b) while some corporate failures may not be directly attributable to corporate governance deficiencies, they have played a major role to the scale of the distress (Citibank); (c) corporate governance needs to be properly aligned with the international attributes of the

MNE (Barings); and (d) international expansion increases the potential for ambiguity of executive actions, the classical agency problem for company boards, where international expansion also increases the risk for asymmetric information (Enron). In these examples I concur with Luo's findings.

Strikingly, I could not identify a single model for subsidiary governance used by the Canadian banks in structuring and operating their subsidiary boards; all factors and mechanisms seem to contribute equally to the overall performance and stability of an organization. However in spite of the variations being used each resulted in overall good governance and stability. This flexibility, then, when properly used and integrated within the larger organizational network, must itself be the best practice for ensuring effective governance. The options as presented by Kiel and Hilb regarding Strategies for Entering and Competing internationally (Kiel), the Degree of Internationalization (Hilb), Subsidiary Degree of Freedom (Hilb) and Governance Options for International Subsidiary Boards (Kiel) were in used by these banks and provided options for these international banks and their subsidiaries. These theories directly explain the variations on subsidiary board structures being used by Canada's Big 5 banks.

According to my research, the variations of subsidiary board structures being used by Canadian banks fell into one of four main categories:

<u>Tier 1 – Very Integrated Subsidiary Board:</u>
These are material subsidiaries or holding companies (e.g. US/UK) that carry significant financial or strategic risk. The subsidiary board would include local independent directors, as well as senior executives (risk or business leaders), and perhaps even the main chair or other main board director.

<u>Tier 2 – Somewhat Integrated Subsidiary Board:</u>
These are important subsidiaries that carry medium financial or strategic risk (e.g. reinsurance/wealth management). The subsidiary board would include local independent directors, as well as head office executives (risk or business leaders), local management and perhaps other local (non-related) management.

<u>Tier 3 – Local Subsidiary Board:</u>
These are important but locally operating subsidiaries (e.g. retail banking) that carry lower financial or strategic risk. The subsidiary board would include high-profile, local and independent directors, as well as some head office executives (risk or business leaders), senior local management and perhaps other local (non-related) management.

<u>Tier 4 – Smaller or Special Purpose Subsidiary Board:</u>
These are subsidiaries that carry the lowest financial or strategic risk to their parent bank (often Special Purpose Vehicles). To avoid these subsidiaries form becoming Puppet Boards (that carry a higher potential for misuse) the Canadian banks not only place subject experts form management on the Board but also experienced non-affiliated management and independent risk officers to oversee the subsidiary governance processes. The Canadian banks have effective risk-based mechanisms in place to ensure even these smaller subsidiaries avoid becoming puppet boards.

For all categories of subsidiaries, changes in the subsidiary will cause the subsidiary board structure to be reviewed and evolve as the organization matures, or as the importance of the subsidiary, its risk profile, or strategic value changed. The findings of Kiel and Hilb in particular helped demonstrate how Canadian banks are monitoring their international subsidiaries boards and makeup to ensuring that they do not present any opportunity for governance breaches.

4.2.2 Transcultural Conduits

Global responsiveness and local effectiveness are of critical importance for generating good governance and financial success in international subsidiaries. Success in only one level creates either financial success that is prone to major crisis (illustrated by the Barings example) or a well-governed subsidiary that is failing on its business goals in local markets (like Canada's bank subsidiaries in the United States). Being truly successful consequently requires a balance between both perspectives. Since current research and practice has been unable to bridge the gap between these macro and micro requirements, I saw the need to develop a new mechanism for this purpose.

In this section I present a new framework called "Transcultural Conduits"[267] for international subsidiary governance and management to unite the two divergent perspectives.

The term "*transcultural conduits*" were first used by Dr. Martín Maldonado-Durán[268], an Argentinean psychiatrist who specializes in the mental health of infants and young children. In a presentation he gave to the Kansas Association of Infant Mental Health (KAIMH), entitled "Practices for Therapeutic Work

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[267] Sears, T – "Transcultural Conduits – Leveraging Cultural Diversity of International Subsidiaries – the Case of RBC in South America" – for the Doctoral Seminar "Management of North and South America" St Gallen University, Dec 2007.

[268] Maldonado-Durán, (2007) ,"Practices for Therapeutic Work within a Cultural /Transcultural Framework" - www.kaimh.org/slides/practice/practice.PPT

within a Cultural and Transcultural Framework", Maldonado-Durán proposed the notion of "transcultural conduits" to account for the need for "staff/translators, persons from the 'same culture" to "find ways to make a bridge" when caregivers find themselves crossing cultural barriers in providing care to infants in foreign cultures. In creating and explaining this term, Dr. Maldonado-Durán is recognizing the need for what Hofstede termed linking pins (translators).

In my analysis of Canada's international banks, I encountered Hofstede's concepts of biculturalism and linking pin roles but in addition I observed enterprise-wide standards and processes which Hilb refers to as glocal processes. By borrowing on Maldonado-Durán's observation and term and building on Hofstede's and Hilb's model I propose a more comprehensive model of Transcultural Conduits. The transcultural processes that the international banks I examined all employed included common operating processes, technology, human resources policies and processes and a strong sense of corporate culture. In joining these enterprise-wide standards, with Hofstede's observations on biculturalism and linking pin roles, provides a more inclusive view of what is allowing global responsiveness and local effectiveness to operate in these international subsidiaries, including governance mechanisms. An expanded definition and model of Transcultural Conduits emerges from my research.

To achieve balance between global responsiveness and local effectiveness requires interconnectivity and implementation on several levels. On one level the subsidiary needs some degree of freedom to address cross-cultural issues as well as to incorporate local products and preferences in the international jurisdiction. At the same time, the subsidiary needs to be actively adhering to governance and other enterprise-wide standards as well as integrating or adapting other required processes, systems, policies and other matters pertaining to company culture.

These conduits allow for the lines of communication between bank headquarters and its international subsidiaries that I discovered were of importance throughout my research. There are the three component parts of trans-cultural conduits:

1. Bicultural Managers:

   Hofstede[269] proposes that cross-cultural success requires executives to be Bicultural – throughout my research I was advised on how these banks build bi-culturality into their organizations from senior executives being responsible for their international divisions through to internal auditors who

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[269] Hofstede –"Culture's Consequence. Comparing Values, Behaviours, Institutions and Organizations across Nations" 2001, pg 440

frequently visited the international locations to build familiarity and biculturality. Hofstede explains:

> "It is my firm impression that the failure rate of non-home-culture executives in multinational business organizations is much higher than that of home-culture executives, precisely because the former frequently do not succeed in becoming sufficiently bicultural".

2. Linking-Pin Employees:

   In examining success across cultures, Hofstede further identifies that employees who are in "linking pin" roles need to also be bicultural – these Canadian banks regularly referenced individuals working in subsidiaries who had been placed in the international subsidiary to serve in these roles in either senior management positions, or less senior roles in technology, risk and finance. Hofstede[270] further explains:

> "Ordinary members of foreign national subsidiaries do not have to be bicultural; only those in "linking pin" roles between national subsidiaries and the international superstructure need biculturality … because these linking agents need a double trust relationship, both with their home-culture superiors and colleagues and with their host-culture subordinates".

In support of Hofstede's proposals, Robert House in the GLOBE Study advised that "Being global is not just about where you do business but how you do it".[271] My researched identified that these international Canadian banks actively employed bi-cultural managers and linking pins employees in the international subsidiaries. These are important building blocks in achieving positive business results and effective governance.

3. Glocal Processes:

   The third element of this merged model is attributed to Hilb and his Glocal[272] Processes. In addition to people, the banks I researched all have processes in place that support the two-way flow of information and ideas. This further helps bridge the cultural and geographic distances between home and foreign environments and also works toward building a "double trust relationship" that Hofstede[273] references.

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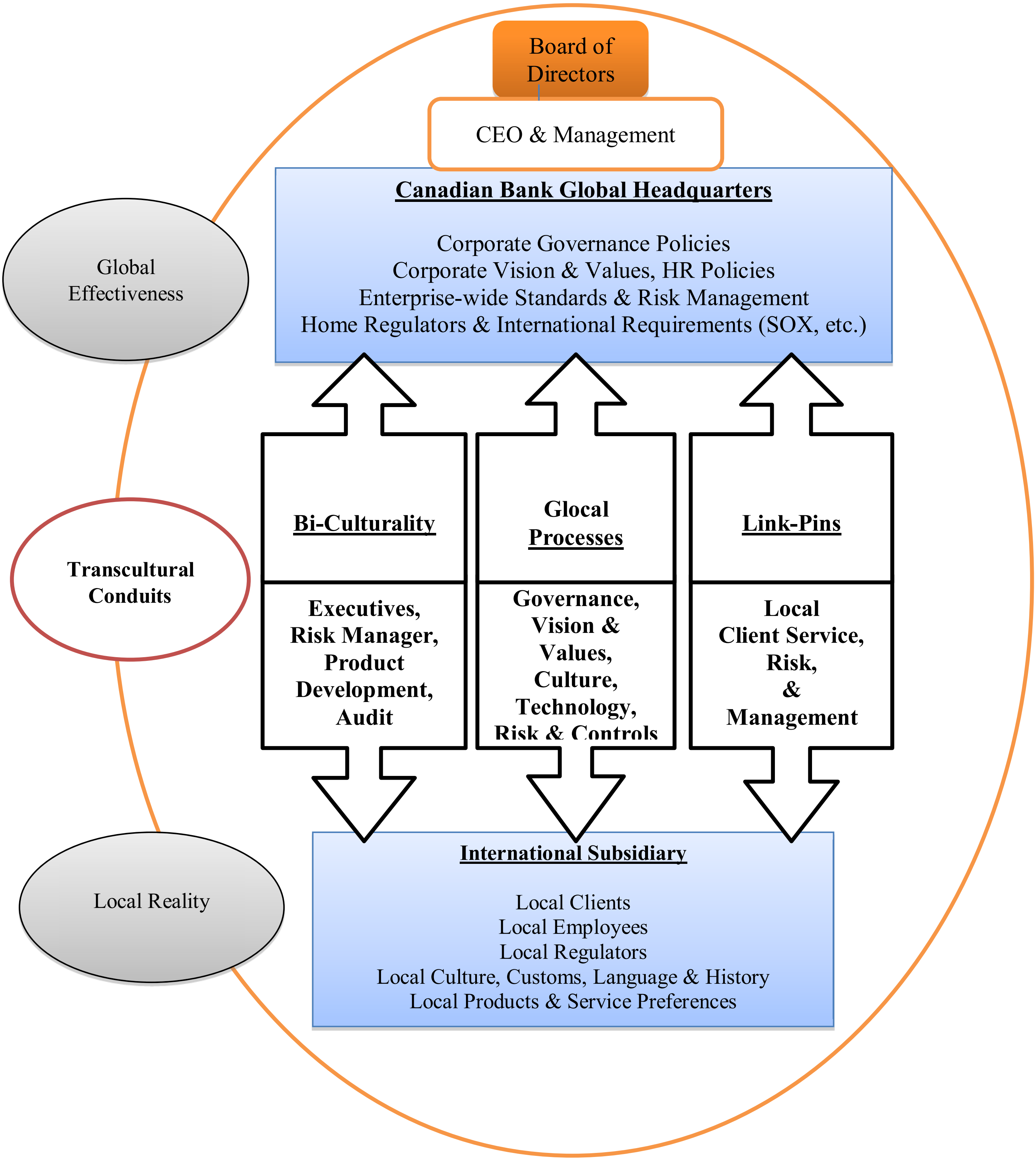
[270] ibid
[271] House et al, "Culture, Leadership and Organizations – The GLOBE Study of 62 Societies", pg 5
[272] Hilb – "Glocal Management of Human Resources" – page 125
[273] ibid, Hofstede (2001)

Figure 14: New Framework for Subsidiary Governance: "Transcultural Conduits"



(Source: Own design, based on Hilb & Hofstede)

Glocal processes communicate expectations of the parent's enterprise-wide standards and the unique needs of the local operating subsidiary. These measures build the confidence of home-culture superiors and allow local products, service delivery, and approaches to be modified in order to meet the local needs of international clients, staff, and stakeholders.

The Glocal Processes I have encountered in my research include:

- Human Resources policies
    - Identifying and enshrining diversity as a corporate strategy
    - Codes of conduct, expected behaviours of all employees
    - Overriding values-based culture
    - Recognition of "subcultures" to support business dynamics
- Enterprise-specific technology
    - Operates within each country
    - Complies with enterprise-wide standards
    - Simultaneously allows local input and global monitoring
- Product policies and processes
    - Standardized products for local client needs
    - Meets and supports bank enterprise-wide policies and practices
- Accounting, auditing and risk management standards and processes
    - Overseeing enterprise-wide standards
    - Acknowledges and allows local exceptions

Grouped together, trans-cultural people and processes act as conduits that connect the banks with its international subsidiaries (see: Figure 14: "New Framework for Subsidiary Governance – Transcultural Conduits"). They ensure that specific clients' needs are being met while also ensuring that enterprise-wide requirements for governance, stability, quality, values and risk management are in effect. Transcultural Conduits further prevent any errors of generalization or stereotyping that might occur and allow both the enterprise and unit to understand and make decisions based on the unique requirements of each situation to subsidiary and the corporation faces. The free flow of information allows for flexibility to handle the complex nature and issues that exit between the subsidiary and the parent organization allowing global responsiveness (enterprise wide-standards) and local effectiveness (cultural, clients and local needs) to be achieved.

It should be clear that Transcultural Conduits work synergistically and holistically to support a two-way flow of information, problem solving and decision making. They serve as the translation buffer that allows international subsidiaries to perform at their optimum levels, meet the needs of both clients and parent organization, while also achieving global standards for "good governance". As people and processes, it is important to also note that these conduits are not static. They form an almost organic structure that adjusts with time and allows the somewhat divergent (and perhaps conflicting) business requirements to work as close to harmony as possible. While nothing is ever perfect, conduits such as these allow for a continuing flow of information that leads to understanding both the local and the global needs of an organization.

4.3 Practical Implications

The primary purpose of this research has been to seek new insights concerning international subsidiary governance for regulators, academics, and practitioners. Canada's banks have been singled out as the most stable banking system in the world, even during a time of international banking crises. Analyzing how they ensure governance in their international subsidiaries provides clear insights and opportunities for learning. There are many ingredients that go into achieving good governance, of course, and each involves a complex web of stakeholders, processes, and behaviors. By speaking with industry experts, this research has been able to identify a number of best practices that were highlighted as contributing to the creation of good governance in Canadian international banks. References made to these factors were weighted according to the number of times they were mentioned (coded), and organized into a total of 114 subcategories (codes), which were then grouped into one of the twenty-two categories.

Appendix 12 (Qualitative Research Categories – Prioritized) presents the twenty-two macro research categories I used to compare financial institutions. I have ranked them based on the total number of citations made by interviewees to each category. From that list, the five most heavily weighted categories that relate to creating good governance are:

1. Integrated Board, Subsidiaries and Management
2. Auditing and Risk Management Function of the Board
3. Focus on Strategy and Future of International
4. Board and Committee Effectiveness
5. Targeted Development of the Board

These were all discussed in detail during the Empirical Review section of this dissertation (Section 3) and they highlight the fact that achieving good governance within international bank subsidiaries depends on a number of factors. To summarize, good governance in Canada's banks stems from effective boards, comprised of carefully selected and continually developed directors. These individuals work with closely management to foster an environment of constructive engagement in board committees and meetings and ensure that their bank's strategic imperatives are being pursued within the confines of pre-determined risks and controls.

Appendix 13 (Research Sub-Categories Sorted by # of Citations) highlights the 114 detailed subcategories within the twenty-two macro categories from my interview data. I have ranked them according to the number of citations made by interviewees relative to that subcategory. This Appendix provides detailed insight to the specific factors affecting governance in these Canadian banks and serves to provide practical insight to many audiences on the most important factors that create good governance in these banks that might have application in their own organizations, institutions, and countries.

For ease of use, I have grouped these findings according to the stakeholder group that they best pertain to (See Section 4.3.1 through 4.3.5):

- Recommendations for Bank Regulators (Domestic and International)
- Recommendations for Bank Boards
- Recommendations for Bank Board Chairs
- Recommendations for Bank CEO's and International Executives
- Recommendations for Nominations & HR Committees of Boards

Each of these groups represents a specific perspective or set of interests relative to corporate governance. I propose that the nominations and HR board committees are of particular importance, because they focus on a broad array of core dynamics that coalesce to create good governance in Canadian banks. CEO selection, chair appointments, director selection, and the creation of soft controls, including the creation of human resources policies, codes of conduct, compensation policies, and other dynamics, are of critical and long-term concern to the goal of achieving good governance. In particular, I heard of the importance of company culture and board renewal in the creation and maintenance of good corporate governance. Although these factors have not been given nearly as much attention in governance literature as they deserve, my research shows how important they are for the general health and stability of Canadian international banks.

What follows are the top 10 Recommendations for the five stakeholder groups listed above as provided by my research. For this purpose the recommendations I are from the top rated sub-Categories that apply to each of the targeted stakeholder groups. By formulating recommendations in this fashion, each stakeholder group can easily identify and extract the specific list that applies to them. Each stakeholder group plays an important but different role in making "good governance" occur in these Canadian banks.

4.3.1 Recommendations for Bank Regulators

Top 10 Recommendations for "Good Governance" - for Bank Regulators -		
#	Recommendation:	Category #
1	Have a few but large diversified banks	14
2	Split the CEO and Chair roles	9
3	Ensure regular meetings and close relations with Boards	6
4	Mandate the independence of audit and risk functions that report to board committees	8
5	Ensure periodic board renewal with outside consultants	22
6	Ensure enterprise-wide risk measures (e.g. risk appetite) are in place	20
7	Create an environment where banks seek excellence	17
8	Diligent supervision is crucial; have appropriate skills in this regard	1
9	Harmonize international regulations and eliminate arbitrage	21
10	Emulate Canada's mortgage system	1 & 2

4.3.2 Recommendations for Bank Boards

Top 10 Recommendations for "Good Governance" - for Bank Boards -		
#	Recommendation:	Category #
1	Be engaged ("Trust but verify")	4 / 12
2	Ensure management processes are achieving board goals	17
3	Ensure governance processes are integrated across the bank	17
4	Ensure subsidiary governance and boards are active and effective	17
5	Focus on strategy and be consistent with bank competencies	13
6	Being international is of growing importance, so evolve and engage accordingly	13
7	Ensure independence and international reach of audit and risk departments	20
8	Evolve governance processes with lessons learned and renewals	6
9	Ensure Transcultural Conduits are in place and working	10
10	Evolve subsidiary board structures to avoid puppet boards	8

4.3.3 Recommendations for Bank Board Chairs

Top 10 Recommendations for "Good Governance" - for Bank Board Chairs -		
#	Recommendation:	Category #
1	Foster constructive engagement within the Board that leads to decision-making	14
2	Ensure good teamwork in the board and with management	17
3	Ensure an environment of respect that includes the "Trust but verify" principle	12
4	Monitor and ensure individual director effectiveness	15
5	Ensure the CEO is serving as the steward of the bank	18
6	Ensure comprehensive board information, planning and reporting	22
7	Ensure board committees are holistically staffed and engaged	22
8	Understand and deliver on the communication function of board	21
9	Develop and monitor the governance of subsidiary boards	7
10	Know and work well with International Regulators	4

4.3.4 Recommendations for Bank CEO's and International Executives

Top 10 Recommendations for "Good Governance" - for Bank CEO's & International Executives -		
#	Recommendation:	Category #
1	Monitor effectiveness of risk management and controls, globally and improve as needed	20
2	Ensure enterprise-wide standards are developed, comprehensive and effective for governance, human resources, technology, branding, risk and audit.	10
3	Develop and expand culture as a governance "soft" control	9
4	Ensure respect and trust between management and board	12
5	Implement GLOCAL effectiveness and responsiveness with Transcultural Conduits	10
6	Avoid puppet boards. Ensure subsidiary boards are active	16
7	Expand international skills in headquarters and subsidiaries	14
8	Recognize the complex challenges of international integration	4
9	Recognize international is strategic and for diversity	13
10	Ensure subsidiaries are within bank strategy and capabilities	17

4.3.5 Recommendations for Nominations & HR Committees of Boards

Top 10 Recommendations for "Good Governance" - for Bank Board Nominations & Human Resources Committees -		
	Recommendation:	Category #
1	Split the CEO and Chair roles	9
2	Select directors according to a skills matrix and underscore the necessary time commitment	15
3	Carefully select CEOs according to bank culture and "boots under the desk", not their ego or past successes	18
4	Carefully select board chairs with strong leadership and facilitation skills, not only technical ability	14
5	Focus board and management on governance and teamwork	14 / 18
6	Develop and expand international skills in head office, the board and subsidiaries	11
7	Continually develop board directors, both domestically and internationally	7/ 15
8	Schedule tri-annual board renewals and use outside consultants	22
9	Compensation drives performance; even bad performance	16
10	Cultivate succession plans for long term stability and culturally strong teams	19

4.4 Recommendations for Further Research in Subsidiary Governance of International Banks

The welcomed response garnered by my research has demonstrated that here is definite interest in this field of governance. I encountered academics, bank executives, industry regulators, and associates in governance circles who believe that international subsidiary governance is an area that has seen very little attention. My research aims to provide insight to this knowledge gap by using Canada's international banks as exemplars of subsidiary governance.

Despite the practical and achievable measures outlined in this dissertation, my research was limited in several ways. First, my research followed a qualitative research design and as a result has developed many theoretical conclusions. These conclusions need to be further vetted and validated using quantitative research designs. In particular, quantitative research should be conducted on the five groups of recommendation listed above (Sections 4.3.1 – 4.3.5) in order to verify and authenticate the conclusions reached. For example, one strong conclusion from my research was that splitting the CEO and Chair roles was a positive effort toward achieving good governance. This was endorsed by bank directors, bank executives, and the expert panel that included Canada's national regulator at OSFI. Yet while this conclusion is strongly supported by my research, regulators in the United States still do not require these roles be split. This has not entirely resulted in the collapse of the US banking system, of course, and many American banks still continue to operate using effective governance standards and practices. An empirical study on this point would subsequently be valuable to international bank practices and governance researchers alike.

Secondly, my research was top-down and only examined what senior bank executives, bank board directors and well-informed outsiders (experts) thought. A number of alternative approaches to studying corporate governance in international subsidiaries are possible, and each would serve to compliment the analysis done in this dissertation. These alternatives include the following:

4.4.1 Bottom-up or Holistic Research

Unlike the work described earlier by Kriger and Gillies, I did not formally interview the employees, executives, directors, or regulators of international subsidiaries. So while my research is certainly relevant for a broad array of audiences both inside and outside of Canada, it does not present a holistic view of Canada's international banking system as it relates to subsidiary governance. A bottom-up approach would help produce a more holistic approach to studying governance but it was beyond the scope of my research program.

4.4.2 Family-held Companies (Power Corp)

An interesting anomaly appeared during my research. As discussed in Section 2.1.5 (Industry Guidelines), the Clarkson Centre's report card grade on each company's governance effectiveness. One company that remains highly praised in industry circles for its transparency, good management and strength in ethics and board effectiveness, does not, however, score well on the CCBE's governance report cards. That company is Power Corporation of Canada,[274] a diversified company that includes banking, insurance and investments activities as well as electricity and gas investments on an international level. Power Corp. is a family-owned and publicly traded company that has independent directors and family members on its board According to their 2011 annual report, Power Corp. states: "We adhere to our governance model in which we are active owners

[274] Power Corporation of Canada, 2011 Annual Report – See: http://www.powercorporation.com/en/

operating through the boards of directors of our controlled companies and present with influence in our core shareholder investments." For these precise reasons, Power Corporation fares poorly in traditional measures of independence and good governance. Yet in spite of their obvious break from corporate governance standards, the company continues to perform well and receives accolades.

The key is this: since Power Corp. is licensed to provide financial services they are regulated in Canada by OSFI. At the conclusion of my interview with Julie Dickson, the head of OSFI, I subsequently added an additional question regarding the anomaly of Power Corp. Her reply underscores the debate on whether family-owned financial institutions should comply with traditional standards for boards and governance. Dickson said:

> **"When you look at a family-owned firm, where it's their money at stake is there an argument that they are different? I think that's very interesting. A lot of the research that we have looked at doesn't help us in that regard. It doesn't help us sort through whether the differences make sense. There is an argument that they ought to be the way they are. I don't know the answer to your question; I just think that they are different."**

It is open for debate whether the Démarias family should be forced to break from their current and indeed successful model and follow industry practices with regard to independent directors. The fundamental issue seems to center on if families that own "public companies" have enough personally at stake that the interest of public shareholders and stakeholders are automatically in alignment with their own. Although my own research did not attend to these questions, they pose interesting subjects for future research in Canada's financial community.

4.4.3 Research Relevance to International Banking in Other Countries

My research focused on Canada's banks and my conclusions are thus directed specifically to bank boards and chairs, CEOs and executives, regulators and board committees. But one could question whether these recommendations are relevant to banking systems outside of Canada. Is there something unique about the Canadian domestic and regulatory environment that simply makes these practices work in Canada, for instance? In fact, with the grave concerns from banks in the United States and Europe, knowing if these recommendations are valid and applicable outside the Canadian contest may prevent international subsidiaries in other countries from collapsing. Such research merits review and examination.

4.4.4 Research Relevance to Other Industries in Canada

As a means of testing their rigour and applicability, the findings I presented above should be vetted against other industries in Canada. It remains to be seen, for instance, whether Canada's banks have successfully operated in difficult times *because* they are a closely monitored and regulated group of companies that are responsible to a broader group of stakeholders. A useful test of this possibility would be to see if my conclusions subsequently apply to companies that do not have such an active and watchful body of regulators. Other industries that would be particularly interesting to compare to the Canadian banks would include Canada's international mining and resources sector or Canada's international manufacturing sector. Such research would ultimately further the field of international subsidiary governance and serve as a compliment to this study.

4.4.5 Research Relevance to Non-banking Industries in Other Countries

At the furthest extreme, do these conclusions and recommendations have merit for other non-banking industries that reside outside of Canada? While I am confident that the best practices presented here do in fact have merit in this capacity, how specific recommendations would be tailored to work in other regulatory environments and relative to other national cultures remains to be seen. Possible candidates might include international technology companies like Microsoft, Intel and Samsung or international food giants like Kraft, and Parmalat or even international media companies which would include Robert Murdock's media empire, might all be of interest.

4.4.6 The Human side of Corporate Governance

In Section 2.1.7 (The Human side of Corporate Governance) I presented Ariely's As a means of testing their rigour and applicability, the findings I presented above should be vetted against other industries in Canada. It remains to be seen, for instance, whether Canada's banks have successfully operated in difficult times *because* they are a closely monitored and regulated group of companies that are responsible to a broader group of stakeholders. A useful test of this possibility would be to see if my conclusions subsequently apply to companies that do not have such an active and watchful body of regulators. If Ariely is correct, future research in corporate governance may start to explore the convergence of social research and management research and propose new breakthroughs in what I call self-governance. If self-governance is achievable, it would surely yield low-cost solutions for "new corporate governance" and present interesting areas for future research.

4.5 Concluding Remarks

Throughout this paper I referenced how breaches of governance resulted in social and financial disaster for companies and their stakeholders. In more recent times, the global financial crisis of 2007-2008 resulted in economic collapse in the United States and, through contagion, into many other regions of the world. The need for effective governance of our banks has never been greater. Yet while governments and regulators have diligently attempted to respond to each crisis with new and supposedly advanced processes and laws, new crises continually emerge on the global scale. At the time of writing, several new events were unfolding that darkened the name of international banks:

- Jamie Dimon, who is the Chairman, President and CEO of JPMorgan,[275] is currently being criticized for the 2012 "London Whale"[276] trading loss. This fiasco is now estimated to be worth at least $5.8 billion in losses and investigators are examining if JPMorgan and Dimon intentionally hid the transactions in question from regulators;

- In the same month, JPMorgan[277] was described as resisting subpoenas related to price-fixing in U.S. electricity markets. It was also accused (by former employees, among others) of deliberately inflating the performance of its investment funds to obtain business.

- HSBC[278] was found guilty of allowing Mexican drug cartels to launder billions of dollars through its US subsidiary and international operations. HSBC apologised and was fined $700 million;

- After paying an initial fine of $450 million to US regulators, Barclays[279] now faces civil and criminal charges over a LIBOR rate manipulation

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[275] Forbes Magazine – "The Real Loss For Jamie Dimon And JPMorgan Chase: Their Integrity" - July 13, 2012 See: http://www.forbes.com/sites/nathanvardi/2012/07/13/jamie-dimon-and-jpmorgan-chase-lose-their-integrity/

[276] CNN-Money: "JPMorgan's trading loss: $5.8 billion" – July 13, 2012 - See: http://money.cnn.com/2012/07/13/investing/jpmorgan-earnings/index.htm

[277] Huffington Post – "Banking is a criminal Industry because its Crimes go Unpunished" – July 16. 2012 – See: http://www.huffingtonpost.com/charles-ferguson/bank-crimes_b_1675714.html

[278] CBC News – "Drug money laundered through HSBC, U.S. Senate probe says" – July 17, 2012 - See: http://www.cbc.ca/news/business/story/2012/07/17/hsbc-mexico-drug-money-laundering.html

[279] The Guardian – "Barclays faces charges in US over LIBOR – report" See: http://www.guardian.co.uk/business/2012/jul/15/barclays-charges-us-libor-report

scandal. Sir David Walker[280] is appointed as the new chair of Barclays in an attempt to undo the reputational damage caused by this incident and other recent misdeeds;

- Visa and Mastercard[281] have just agreed to pay $7 billion to settle a private antitrust case filed by thousands of merchants who alleged that both companies colluded to fix fees and terms of service.

The interconnected nature of international banks means that one bank's misdeeds weaken the entire global network of financial institutions. As a result, the need for good governance practices across all companies, especially banks, has never been needed more. This is particularly evident in the general social unrest that is growing across the globe. The so-called Occupy Movement throughout North America, the multiple strikes and unrest in the United Kingdom, and marches and demonstrations throughout Europe—notably in the worst affected countries such as Greece, Spain, Portugal and Italy—all serve as a poignant reminder that the need for stable and reliable banks has never been greater.

The goal for doing this research was to understand what makes banks stable and provide recommendations that would reduce the number of governance crises. These collapses and financial failures cause a host of innocent bystanders to lose their jobs, their savings and their quality of life due as a result of the selfish or careless acts of a few. This occurred equally after the collapse of Barings Brothers, Enron, WorldCom, Arthur Anderson, and others. Stakeholders in these firms, who were themselves not involved in the misdeeds and who would not stand to benefit any of these governance breaches, were dramatically affected: employees lost their jobs, investors lost their capital and taxpayers were are often called up to bail out these failing companies or industries.

Although governance remains the responsibility of every employee, it rests ultimately with a company's board of directors. This is true of banks and other institutions. So while my research has demonstrated that good governance appears to be working in Canada's banking system, current and historical examples seems to illustrate that effective governance in general is still lacking. My research subsequently presents several lessons for academics and practitioners of governance alike:

1. Regulation does indeed drive change but regulation alone is not enough to prevent breaches of governance from occurring on a large scale.

[280] Cimilluca, D., Schaefer Munoz, S. *"Barclays Names Walker as Its New Chairman",* Wall Street Journal, August 10, 2012
[281] Star Tribune, Minneapolis – "Retailers win $7.25B in settlement over credit card fees" July 14, 2012 – See: http://www.startribune.com/business/162437066.html

2. There is an identifiable element within human behaviour that believes fraud is acceptable when one can get away with it.
3. The Canadian banking system seems to have balanced many complex parts of its international organizations to achieve good governance at a general level.
4. The pressure for organizations to grow internationally continues, as the situation of Canadian banks illustrates. This will create more international subsidiaries and will increase the future complexity for boards and subsidiary boards, especially concerning matters related to governance.
5. With increased internationalization, Canadian banks will need to continually evolve the skills and competencies of their main board. They will also need to expand the international competencies of their executive, risk and audit teams and other key control and oversight functions.
6. "Puppet boards" are dangerous for "good governance" and must be avoided by all companies (and international ones in particular).
7. Regulators continue to propose new regulations whenever new crises hit. This will add to the complexity of doing business internationally and create a form of regulatory arbitrage. This may actually be an undesired consequence of regulators own reliance on formal laws and processes.
8. There are, undoubtedly, other breaches of governance currently being perpetrated; it is also likely that additional breaches of governance will be perpetrated in the future.

Although these concerns may be discouraging to optimistic proponents of good governance, comfort can be found by realizing that the vast majority of employees are honest and hardworking individuals. With proper guidance, incentives and training, it is likely that they will stay honest and law-abiding. Although we have still not found the absolute blend of ingredients that creates good governance for every organizational structure and business environment, the situation is improving because of the continued interest by academics, regulators and practitioners in achieving this goal. More work still needs to be done.

One such leading thinker is Roger Martin, Dean of the Rotman School of Management. In his most recent book, "*Fixing the Game*"[282], Martin argues that capitalism itself is broken and needs to be fixed. His views may have some element of

[282] Martin, R. (2011), *'Fixing the Game: How Runaway Expectations broke the Economy, and how to get back to Reality'*, Harvard Business School Publishing, Boston, USA

truth and his underlying perspective that the status quo in business is not working is a growing view across North American and the world.

This dissertation is presented with the purpose of adding to the body of knowledge about processes and techniques that generate good governance. I believe that regulators and lawmakers have an important role to play, although the ultimate responsibility for "good governance" rests with boards.

It is clear that boards are evolving and getting better. It remains to be seen if others can learn from the lessons offered by Canadian international banks and their subsidiaries.

One bank executive I met summarized it well when she said: "Governance is not a destination - it is a journey". If the quest for corporate governance is a journey I must conclude this paper by saying …

….. the journey continues.

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Appendices

Appendix 1 - Development of International Corporate Governance [283]

Author	Year	Report	Comments Or Key Suggestions
British Accounting Standards and Steering Committee (UK)	1975	"The Corporate Report"	All economic entities to report publicly and accept accountability for the impact of director's decisions
Rhys Williams (UK)	1977	"The Conduct of Company Directors"	Green Paper presented to British Parliament – did not see the light of day
London Stock Exchange & Financial Reporting Council The Cadbury Committee (UK)	1992	"The Financial Aspects of Corporate Governance" The Cadbury Report	Boards should have checks and balances to ensure that no single individual could have "unfettered powers of decision", should have at least 3 non-executive members of which 2 should be fully independent, should have an audit committee, and should explain its corporate governance procedures.
Rutterman Committee (UK)	1994	Rutterman Report	Internal control and financial reporting
Greenbury Committee (UK)	1995	"Directors' Remuneration: the report of a study group" The Greenbury Report	Transparency or lack thereof in directors remuneration disclosure in the UK
Hampel Committee (UK)	1995	"Committee on Corporate Governance" report"	Reviewed the decisions of the Cadbury committee and included more detailed and more rigid prescriptions for companies, boards of directors and audit processes.
California Public Employees Retirement System (CalPERS)	1997 and revised in 1999	Global Corporate Governance	Good governance needs to be accountable and transparent.
Business Roundtable (the chief executives of the top 250 companies in US)	1997	Statement on Corporate governance	Revised roles of boards committees, the composition of the board and the evaluation of governance process.
The Turnbull Committee (UK)	1998	Turnbull Report	Implementing a risk-based approach to systems of internal control and meaningful disclosure
The Asia Pacific Economic Cooperation symposium (APEC)	1998	APEC finance ministers report	Improve corporate governance in the region to assist in restoring financial stability and growth the ravaged South East Asian Tiger Economies.
Organization for Economic Co-operation and Development	1998	Corporate Governance Report: Improving Competitiveness and Access to Capital in Global Markets	Protection of shareholders rights, equitable treatment of shareholders, the role of stakeholders in corporate governance, disclosure and transparency and the responsibilities of the board. Integrity of internal control structures and accountability, transparency and disclosure of board members and executive staff.
The Hampel Report	1998	The Combined Code	Requires companies to provide disclosure statement on their adherence to the principles of good governance
US Federal Government, NYSE	2002	Sarbanes-Oxley Act	Required that the CFO and the CEO certify that the verity of the financial statements and be personally responsible for them
Coordinating Group on Auditing and Accounting Issues in the UK (CGAA)	2003	Final CGAA Report	Recommended the formation of an independent group to develop the existing guidance on audit committees contained in the Combined Code and to clarify the roles of audit committees with the backing of the British Financial Reporting Council
Derek Higgs (UK)	2003	Higgs Report	Independent review of the role and effectiveness of non-executive directors on a board of directors
European Corporate Governance Forum	2004	"High level Group of Experts" Report	To enhance the convergence of national corporate governance code

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Appendix 2: Courses offered by the Canadian Securities Institute

1. Securities Sales Licensing:
   - Canadian Securities Course (CSC)
   - Conduct and Practices Handbook Course (CPH)
   - Wealth Management Essentials (WME)
   - New Entrants Course (NEC) in lieu of the CSC and CPH.

2. Mutual Fund Sales Licensing:
   - Investment Funds in Canada (IFC) or the Canadian Securities Course (CSC)

3. CSI Courses required for other licensing requirements:
   - Investment Management Techniques (IMT)
   - Portfolio Management Techniques (PMT)
   - Derivatives Fundamentals Course (DFC)
   - Options Licensing Course (OLC)
   - Futures Licensing Course (FLC)
   - Branch Manager's Course (BMC)
   - Effective Management Seminar (EMS)
   - Options Supervisor's Course (OPSC)
   - Canadian Commodity Supervisor's Qualifying Examination (CCSE)
   - Partners, Directors and Senior Officers Course (PDO)
   - Chief Compliance Officers Qualifying Examination (CCO)
   - Chief Financial Officers Qualifying Examination (CFO)
   - Trader Training Course (TTC)
   - Branch Compliance Officers Course

Appendix 3: Dependent Variables for Successful Subsidiary Governance (DRAFT)

1. Existence of a Subsidiary Governance Office (SGO) in Head Office. SGO Responsibilities include:
    a. Written policy manual on corporate governance of subsidiaries
        i. Director's obligations and roles
        ii. Board obligations, approvals and authorities
        iii. Process for conducting Board meetings
        iv. Policy on distribution of Board materials, recording of minutes, appointing/terminating directors
        v. Policies as appropriate for wholly-owned subsidiaries and partially owned subsidiaries
    b. SGO oversight of subsidiary activities
        i. Maintain a copy of all subsidiary minutes
        ii. Maintain list of all subsidiary directors
        iii. Oversee required frequency of subsidiary Board meetings, and director attendance
        iv. Oversee selection process of all new Directors
        v. Oversee subsidiaries as regulatory and internal polices change Board or governance practices
    c. SGO is staffed with competent professionals
        i. Subsidiary Governance Officer – professional corporate lawyer reporting to the Corporate Secretary
        ii. Other lawyers and paralegals as needed for oversight and administration of subsidiaries
        iii. SGO team members serve as Corporate Secretary to all material subsidiaries
    d. SGO identifies and manages the full portfolio of company subsidiaries
        i. Approval of all new subsidiaries created
        ii. Annual evaluation of on-going need for each subsidiary
        iii. Approval and oversight of subsidiary termination and proper closing
        iv. Provide subsidiary Directors with escalation process for queries or concerns
    e. Existence of a Subsidiary Oversight Committee
        i. Members are representatives of SGO, Finance, Group Risk, Compliance, Law, Internal Audit
        ii. Evaluate SGO activities, monitor pending changes to internal governance or regulations & collaboration
        iii. Formal meetings Quarterly
2. Directors of the Main Board serve as Chairman for material international subsidiary Boards
3. Independent Directors are appointed to material International subsidiary Boards
4. Head Office business executives serve as Directors on material International Subsidiary Boards
5. Subsidiary CEO serves as Director on International Subsidiary Boards
6. Subsidiary CEO is not Chairman for material International Subsidiary Boards
7. Each material subsidiary has a full time Risk Officer located in the subsidiary, reporting independently to the Chief Risk Officer

Appendix 4: New Corporate Governance of International Subsidiaries – Survey

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Thank you for agreeing to participate in our survey regarding corporate governance of international subsidiaries. Your answers will be kept in strict confidence, accumulated with all other respondents' replies and will be used solely for statistical analysis of governance practices in effect in Canada.

ABOUT YOUR COMPANY:

1. What is the ownership/legal structure of your organization? (Pick one)
__ Publicly Traded – Widely held (shareholders)
__ Publicly Traded – Closely held (shareholders)
__ Private Company
__ Government Organization
__ Not-for Profit Organization
__ Other

2. To what industry does your organization belong - by main revenue (Pick one)
__ Banking Finance or Insurance
__ Manufacturing
__ Telecommunications
__ Accounting, Auditing or Consulting
__ Legal
__ Retail
__ Education
__ Health
__ Media
__ Utilities
__ Energy
__ Transportation
__ Hospitality/Tourism
__ Government
__ Other

3. Where is the Global Headquarters of your organization located? (Pick one)
__ Canada
__ United States
__ Europe / UK
__ Japan
__ Asia
__ Other

4. Is your Office the Canadian Headquarters
__ Yes
__ No

5. Approximately how many employees does your company have globally?
__ Less than 1000
__ 1,001 - 5,000
__ 5,001 - 10,000
__ 10,001 - 20,000
__ 20,001 - 50,000
__ More than 50,000
__ Don't know

Appendix 4: New Corporate Governance of International Subsidiaries – Survey

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6. How large is your organization based on net annual income last year. (Pick one)
__ Less than $1 million
__ $1 million - $24 million
__ $25 million - $99 million
__ $100 million - $499 million
__ $500 million - %999 million
__ $1 billion - $1.99 billion
__ $2 billion - $10 billion
__ More than $10 billion
__ Don't know

7. Approximately what % of your organization's revenues come from outside of Canada? (Pick one)
__ Zero %
__ Between 0% and 9%
__ 10% - 19%
__ 20% - 39%
__ 40% - 59%
__ 60% - 79%
__ More than 80%
__ Don't know

8. Approximately what % of your organization's employees is located outside of Canada? (Pick one)
__ Zero
__ Between 0% and 4%
__ 5% - 190%
__ 20% - 39%
__ 40% - 59%
__ 60% - 79%
__ More than 80%
__ Don't know

RESPONDENT INFORMATION

10. Please chose the Job Title that best matches your own:
__ Board Director/Chairman - Non-Executive (including International Subsidiaries)
__ CEO
__ Member of the Senior Management Team
__ Corporate Secretary/Governance Officer
__ Legal Counsel
__ Risk Officer
__ Human Resources Officer
__ Public Relations Officer
__ Other

11. How many years have you been with this company? _____________

12. Are you a citizen of a county outside of Canada? Yes: _______ No: _________

ABOUT YOUR COMPANY'S MAIN BOARD AND DIRECTORS

1. How many Directors are there on your Company's Main Board? __________
2. How many of your company's Directors live outside of Canada? __________

(IF YOUR COMPANY DOES NOT HAVE INTERNATIONAL OPERATIONS, SKIP THE NEXT SECTION)

Appendix 4: New Corporate Governance of International Subsidiaries – Survey

Page 3

ABOUT YOUR COMPANY'S NON-CANADIAN (INTERNATIONAL) SUBSIDIARIES & SUBSIDIARY BOARDS

The focus of this section is your Company's key (revenues, assets or people) subsidiaries located outside of Canada and the Main Board's DIRECT and INDIRECT connections to these international interests.

1. If your company has international operations, rank the importance of your company subsidiaries located outside of Canada? (1 = highest, then 2, then 3, etc. Leave blank where there is no presence)
__ United States
__ United Kingdom
__ Europe
__ Caribbean
__ Latin/South America
__ Middle East
__ Asia
__ Australia
__ Other: ______________
__ Not Applicable

2. Roughly how many different countries does your organization have a subsidiary or branch?
__ Under 10 countries
__ 11 – 20 countries
__ More than 20 countries
__ Don't know/Not Applicable

3. Strategically, what best describes your company's expectations towards your international business:
__ Expected to decline
__ Expected to remain about the same
__ Expected to grow
__ Don't know/Not Applicable

4. Does your Company have a policy on the selection of Subsidiary Directors? (Pick one)
__ Yes
__ No
__ Don't Know
__ Not Applicable

5. Typically what type of individual sits as a Director of your Company's key international subsidiaries? (Pick all that apply)
__ Local company executives (only) are preferred for key subsidiaries
__ Local executives and Head Office executives (only) are preferred
__ Head Office executives must serve as Directors of key Subsidiaries, by policy
__ Local non-executives, only if required by local law
__ A mixture of company executives and local non-executives are preferred (or by policy)
__ Member(s) of the main Board of Directors must serve on subsidiary Boards, by policy
__ Member(s) of the main Board of Directors are preferred to serve on subsidiary boards
__ Don't know

6. **By policy**, do key international subsidiaries have independent Risk Officers in the location and to whom do they report (Pick one).
__ No
__ Yes - reporting to local subsidiary Management
__ Yes - reporting to Head Office/Regional Business Management
__ Yes - reporting separately to Chief Risk Officer
__ Yes - reporting separately to other Head Office/Regional Officer
__ Yes – but don't know

Appendix 4: New Corporate Governance of International Subsidiaries – Survey

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7. What subsidiary Board sub-Committees (not Management Committees) exist in key International Subsidiaries, by company policy? (Pick all that apply)
   __ None (by policy)
   __ Audit Committee
   __ Risk Committee
   __ Audit & Risk Committee Combined
   __ Compensation/HR/Nominating Committee
   __ Governance Committee
   __ Appeals/Ombudsman Committee
   __ Strategy/Planning Committee
   __ Investment Committee
   __ Other
   __ Don't know

8. Aside from Company policy, what subsidiary Board sub-Committees (not Management Committees) typically exist in key International Subsidiaries? (Pick all that apply)
   __ None (by policy)
   __ Audit Committee
   __ Risk Committee
   __ Audit & Risk Committee Combined
   __ Compensation/HR/Nominating Committee
   __ Governance Committee
   __ Appeals/Ombudsman Committee
   __ Strategy/Planning Committee
   __ Investment Committee
   __ Other
   __ Don't know

9. Regarding the Chairman of the international Subsidiary Board (Pick all that apply):
   __ We prefer the Chairman to be an outside independent Director
   __ We prefer the Chairman to be the CEO of the Subsidiary
   __ We prefer the Chairman to be an executive from Head Office or another regional executive
   __ We prefer the Chairman of the subsidiary to be on the main Board of Directors
   __ We have no policies or guidelines on this
   __ Don't know

10. How do Directors of International Subsidiaries stay aware and of Corporate Direction and Strategy, and how does the Main Board stay aware of activities and issues in key international subsidiaries? (Pick all that apply)
   __ All directors of key international subsidiaries are employees of the company
   __ Local & Head Office Executives bridge the Main Board and subsidiary
   __ The main Board sends written materials to international directors
   __ The Subsidiary Governance Office sends materials to international Directors
   __ International directors participate in sessions with Main Board Directors
   __ A Main Board Director sits as a Director of each key international subsidiary
   __ A Main Board Director sits as Chairman of each key international subsidiary
   __ Directors of key subsidiaries have prescribed escalation procedures
   Other (please describe):
   ____

11. Does your company have a separate Subsidiary Governance Office and Subsidiary Governance Officer? (Pick one)
   __ Yes, both Subsidiary Governance Office and Officer (see Section 4)
   __ Yes, Subsidiary Governance office only (See Section 4)
   __ No, this falls under our Corporate Secretary
   __ No, this falls under another area in our company
   __ Yes – but don't know
   __ Don't know

Appendix 4: New Corporate Governance of International Subsidiaries – Survey

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12. What functions do your SGO perform? (Pick as many as applies)
    __ Not applicable
    __ Written policy manual (responsibilities and authorities of Directors)
    __ On-going oversight of subsidiary activities (minutes, meetings, etc.)
    __ Provide new subsidiary directors with company induction and governance training
    __ Selection process for all new subsidiary directors
    __ Establishing standards and formats for Board operations
    __ Provide subsidiaries with regulatory updates affecting governance issues
    __ Review proposals for all new subsidiaries created and each on-going subsidiary
    __ Provide escalation ("whistle-blowing") process for all subsidiary directors
    __ Regular reporting & review of subsidiary activities to Sr. Management
    __ Other (please specify) ____

13. Regarding you Subsidiary CEO's role on the Subsidiary Board (Pick all that apply)
    __ Subsidiary CEO's are usually a Director of the Subsidiary Board
    __ The Company prefers the subsidiary CEO to NOT be a Director of the Board
    __ Subsidiary CEO's are usually the Chairman of the Subsidiary Board
    __ The Company has a policy that the subsidiary CEO is NOT to be Chairman of the Board
    __ Don't know
    __ We have no such policies or guidelines on this

14. Regarding oversight and governance what are the chief oversight mechanisms used for ensuring governance of your key international subsidiaries? (5 = high; 0 = none or N/A)

	5	4	3	2	1	0
Subsidiary Board	__	__	__	__	__	__
External Audit	__	__	__	__	__	__
Internal Audit	__	__	__	__	__	__
Local Regulators	__	__	__	__	__	__
Local Risk Officer	__	__	__	__	__	__
Local Management	__	__	__	__	__	__
HO Management	__	__	__	__	__	__
SG Office/r	__	__	__	__	__	__
Other HO Executives	__	__	__	__	__	__
Local Compliance Officer	__	__	__	__	__	__
Other	__	__	__	__	__	__
Don’t Know	__	__	__	__	__	__

15. How satisfied are you that the geographic representation on your main Board adequately includes the experiences and backgrounds to provide effective governance of your company’s international subsidiaries, risks and potential liabilities?
    __ Very Satisfied
    __ Satisfied, but there is room for improvement
    __ There is clearly room for improvement
    __ Don't know/Not Applicable

16. How satisfied are you that your Board Directors are adequately experienced and informed to provide proper governance oversight of your international subsidiaries?
    __ Very Satisfied
    __ Satisfied, but there is room for improvement
    __ There is clearly room for improvement
    __ Don't know/Not Applicable

Thank you! This has been very helpful.
<u>Please return by mail or e-mail to:</u>
Thomas C. Sears
Doctoral Candidate, St Gallen University
E-mail completed surveys or questions to: Tom.Sears@Rogers.com

<u>If you are willing to be interviewed as part of our research, please indicate</u>

Appendix 5: Target Interviews

Target Interviews for Research - Corp. Governance of Int'l Subsidiaries - Canadian Banks				
Bank	**Chairman**	**Director**	**CEO**	**Risk Officer**
TD Bank		**John Thompson**		**Mark Chauvin**
Interview:		(past Chairman) **Completed** June 5 & June 20		**Completed** 15-Sep-11
CIBC		**Nick LePan**	**Gerry McCaughey**	
Interview:		**Completed** 29-Aug-11	**Completed** June 1 - 11am	
Royal Bank of Can.	**David O'Brien**			**Morten Friis**
Interview:	**Completed** 24-Aug-11			**Completed** 28-Jun-11
Bank of Montreal	**David Galloway**	**David Beatty**		
Interview:	**Completed** 22-Sep-11	**Completed** May 26 - 2pm		
Bank of Nova Scotia	**John Mayberry**		**Rick Waugh**	
Interview:	**Completed** 20-Jun-11		**Completed** 29-Sep-11	
Industry Stakeholders:	**Name**	**Title:**	**Interview:**	**Date:**
OSFI	**Julie Dickson**	Superintendent	**Completed**	21-Oct-11
US SEC Report	**Robert Pozen**	Author & Lecturer	**Completed**	30-Jun-11
Can Bankers Ass.	**Terry Campbell**	CEO	**Completed**	22-Sep-11
UK - Fin Rept C.	**Sir David Walker**	Author & Advisor	**Completed**	12-Oct-11
York University	**Richard Leblanc**	Author & Lecturer	**Completed**	29-Sep-11

(Source: Own Design)

Appendix 6: Corporate Governance of International Banks - Interview Schedule

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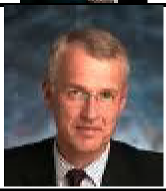
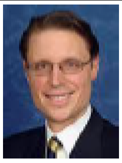
Interviewees – New Corporate Governance of International Canadian Banks Page 1				
Interviewee:	**Name:**	**Title:**	**Organization:**	**Date of Interview**
	David Beatty	Director	Bank of Montreal	May 26, 2011
	Gerry McCaughey	CEO	CIBC	June 1, 2011
	John Thompson	Director & Past Chairman	TD Bank	June 5, 2011 June 20, 2011
	John Mayberry	Chairman	Scotia Bank	June 20, 2011
	Morten Friis	Chief Risk Officer	RBC	June 28, 2011
	Robert Pozen	Author – SEC's US Bank Review	Harvard University (USA)	June 30, 2011
	David O'Brien	Chairman	RBC	August 24, 2011

(Source: Own Design)

Appendix 6: Corporate Governance of International Banks – Interview Schedule

Page 2

Interviewees – New Corporate Governance of International Canadian Banks Page 2				
Interviewee:	**Name:**	**Title:**	**Organization:**	**Date of Interview**
	Nick LePan	Director, & Chair of the Risk Committee	CIBC	August 29, 2011
	Mark Chauvin	Chief Risk Officer	TD Bank	Sept. 15, 2011
	David Galloway	Chairman	Bank of Montreal	Sept. 22, 2011
	Terry Campbell	CEO	Canadian Banker's Association	Sept, 22, 2011
	Rick Waugh	CEO	Scotia Bank	Sept. 29, 2011
	Dr. Richard LeBlanc	Author & Lecturer	York University	Sept. 29, 2011
	Sir David Walker	Author of the "Walker Report" on UK Banking	Morgan Stanley (UK)	October 12, 2011
	Julie Dickson	Superintendent	Office of the Superintendent of Financial Institutions	October 21, 2011

(Source: Own Design)

Appendix 7: Corporate Governance of International Subsidiaries Interview Questions

Page 1

Interview Structure & Questions:

1. **How Corporate Governance works in your Bank:**

1.1 How has your bank achieved Excellence in Corporate Governance?

1.2 How does your Bank bring the Risk Management function into the Board?

1.3 With regard to the recent Economic Crisis – why has THIS Bank performed better than other banks around the world and other banks within Canada?

1.4 In Canada we have recently seen how decisions made by Manulife's Board diminished shareholder value. Do you think that type of decision making could occur at your Board? Why or why not?

1.5 Are there any areas of pride or leadership you feel this Bank has led in area of Corporate Governance?

1.6 Has your bank experienced breaches in Corporate Governance and if so, how were they resolved and what were the lessons learned?

1.7 How can you be certain that your Board is balanced and does not give over the "Group Think"?

1.8 Academics and regulators debate the future direction for Boards. Some (Pozen – "Professional Boards") suggest that smaller boards with individuals that have expertise in the field (of banking) and have more time to dedicate to fewer Boards is the way to go. Others (Nestor) suggest that additional management members should join the Board to provide additional expertise and debate at the Board level. In the UK and Europe there is a focus on increased involvement of Board members in Committees and Subsidiaries (Hilb). What are your views on these suggestions?

Appendix 7: Corporate Governance of International Subsidiaries Interview Questions

Page 2

2. Governance of bank International subsidiaries:

2.1 How important are your international subsidiaries in the short and long term strategies of your Bank?

2.2 With the increasing complexity of cultures, time zones, markets and language, how does your bank ensure governance within your international subsidiaries?

2.3 How familiar would you say your Main Board Directors are with your key international subsidiaries and the international issues that might affect Corporate Governance in the Bank?

2.4 Conversely, how do Directors in international subsidiaries stay "connected" to the main Board and the Governance needs of the parent company?

2.5 Do any Main Board Directors sit as Directors of international subsidiaries and if so how does that work and if not have you considered this?

2.6 As you look into the future of banking, and your international strategy, what do you see as the greatest challenges for Governance for your Board of Directors and what changes do you see ahead?

3. In Conclusion:

3.1 Is there anything else we have not discussed that you would like to mention as part of this research?

3.2 Are there any other individuals in your organization I should speak to?

3.3 Would you be willing to allow us to create a Business Case on your bank highlighting some "Best Practice" in your bank's Governance Practices for learning purposes?

Appendix 8: Interview Request – E-Mail

From: Tom Sears [mailto:Tom.Sears@Rogers.com]
Sent: 17 June 2011 11:35
To: NLepan@Rogers.com

Subject: Corporate Governance Research

Dear Nick,

We have not met, but both David Beatty (who gave me your personal e-mail address, I hope you do not mind) and some friends at OSFI suggested that I should contact you. I waited until I cleared this request with Gerry McCaughey, which I got on Wednesday.

I am a retired Executive of RBC who now teaches at Rotman in Toronto.

I have been working on my PhD since 2007 on the subject of Corporate Governance of International Subsidiaries. I am now in the final year. My research is being conducted via interviews with board Directors, Chairmen and Sr. Executives. I interviewed Gerry McCaughey on Wednesday and he has encouraged me to connect with you, so here I am. I will send you more details if you agree to be interviewed (confidentiality, process, etc.) but I thought I would seek your concurrence and if so to see if we could schedule a date. I'm in Port Hope but in Toronto regularly and can get to Ottawa if that works better for you.

The interview lasts about an hour.

To date I have interviewed John Thompson, Gerry McCaughey and David Beatty and have agreement from David O'Brien (August), John Mayberry (Monday), Morten Friis (June 28th) and other industry stakeholders.

Here is the executive summary of the focus and I will send you more detail on the interview process if you think you can spare the hour. I hope you do not mind me reaching out to you like this.

Kind regards,
Tom.

P.S. I really enjoyed your presentation and comments at the ICD Conference last week.

Thomas C. Sears, Doctoral Candidate
St Gallen University, Switzerland (affiliated with the Rotman School of Management)
243 Ward St.
Port Hope, ON. L1A 4A4
H: (905) 800-0548
M: (416) 409-3441
E: Tom.Sears@Rogers.com

Appendix 9: Interview Confirmation – E-Mail

(Mr. Nick LePan – Board Director CIBC & Chair Risk Committee)

From: Tom Sears [mailto:Tom.Sears@Rogers.com]
Sent: 26 August 2011 11:06
To: nlepan@-----.com
Subject: RE: Corporate Governance Research

That's terrific Nick,

Here is 1) the outline for the interview, plus 2) my CV for your information.

I'm looking forward to seeing you on Monday at 2pm on the 44th Floor, Commerce Court West.

Enjoy the weekend.
Tom.

From: nlepan@rogers.com [mailto:nlepan@------.com]
Sent: August-26-11 10:37 AM
To: Tom Sears
Subject: Re: Corporate Governance Research

Hi Tom,
Yes 2 pm is on. If you come to the corporate secretary's division on the 44th floor of commerce court I have arranged a meeting room there. In case you need to get to get in touch with me my cell number is xxx xxxxxxx. An hour or a bit more is fine.

Did you send me anything on what you want to cover?

Regards,
Nick

From: Nick Le Pan [mailto:nlepan@------.com]
Sent: June-17-11 1:09 PM
To: 'Tom Sears'
Subject: RE: Corporate Governance Research

Hi Tom,
I would be very happy to do this.

Regards,

Nick Le Pan

Appendix 10: Interview Outline sent to Interviewees

Background:

- Companies continue to expand internationally for new revenues and sources of inputs. As they do risk, and complexity increases.
- International subsidiaries of multinational corporations can become material operations and have caused operational and governance breaches for their parent organizations (Barings, Parmalat, AIG, etc.)
- Famous failures (Maxwell, Enron, WorldCom, etc.) have resulted in increased regulation and demand for governance from regulators (OECD, SOX, etc.)
- Corporate Governance ultimately rests with the Board of Directors, often located in the company's home jurisdiction. How do Corporate Boards ensure appropriate governance and oversight across international boundaries, cultures and time zones?

Premise:

- The most recent economic crisis (2007/2008) has focused attention on the collapse of banks and bank capital around the world.
- Canadian banks have been ranked by the OECD (2008) as the "World's Soundest Banks" having emerged relatively unscathed from the 2007 economic crisis.
- Canadian Banks are very international in their make-up.
- What can we learn from the Canadian banks regarding Governance practices and in particular how they overcome the risks inherent in operating thousands of miles away, in cultures and (possibly) products unfamiliar from the home market.

Research Objectives (via Interviews with Canadian Bank Board Directors/Chairs, senior bank executives and significant industry stakeholders:

1. To learn what senior bank executives in Canada feel are the key contributors to the success of their bank in Corporate Governance.

2. To discover what are the Governance needs and the solutions to address the unique circumstances in the banks' International subsidiaries.

3. To hear what Canadian Banks (ranked #1 by the OECD) feel are the needs for Governance going forward as the world continues to get more complex and more global.

Appendix 11: Interviewee Transcript for Review and Approval – E-Mail

From: Tom Sears [mailto:Tom.Sears@Rogers.com]
Sent: 31 August 2011 13:15
To: nlepan@------.com
Subject: RE: Corporate Governance Research

Dear Nick

First – thank so much again for all of your time and your insights. It was an excellent interview for my research.

As promised here is the transcript of our interview. I would ask you to review it and confirm with the following points in mind:

1. Please do NOT be fussed with the conversational nature of the text or the grammar or the structure. I am seeking the ideas, concepts and concerns you expressed;
2. Please review and confirm that the transcript "reasonably represents" the comments you made to my questions;
3. Please feel free to make any corrections, deletions or additions you feel important to you, CIBC or this research. I am not looking to disclose trade secrets. I will make changes and send you back a FINAL edition in PDF format for your file.

If you can send Julie Dickson that e-mail we discussed, it might help open the door for me!

It was fascinating to talk to you. I look forward to hearing back when you have had a chance to review this.

My contact details are below if you need to reach me.

All the best,
Tom.

Thomas C. Sears, Doctoral Candidate
St Gallen University (affiliated with the Rotman School of Management)

243 Ward St.
Port Hope, ON. L1A 4A4
H: (905) 800-xxxx
M: (416) 409-xxxx
E: Tom.Sears@Rogers.com

Appendix 12 – Qualitative Research Categories – Prioritized

Research Categories Sorted by Total # of Citations:			Total	% of	Total	Avg. Per	
Rank	Thesis #	Research "Category"	Subjects	Subjects	Citations	Subject	KISS Principle
1	17	Integrated Board, Subsidiaries and Manag	15	100%	178	11.9	Integrated
2	20	Auditing and Risk Management Function (	15	100%	139	9.3	Control
3	13	Focus of Strategy and Future of Internatic	15	100%	114	7.6	Strategic
4	22	Board and Committee Effectiveness	12	80%	88	7.3	Control
5	16	Targeted Development of the Board	14	93%	66	4.7	Integrated
6	11	Targeted, Diverse Board Composition	15	100%	64	4.3	Strategic
7	2	Canadian Domestic Environment	15	100%	63	4.2	Situational - E
8	21	Controlling Function of the Board	13	87%	62	4.8	Control
9	19	Effective Management and Company Cult	13	87%	62	4.8	Integrated
10	5	Breaches of Governance:	14	93%	57	4.1	Situational - E
11	15	Targeted Board Selection, Feedback and E	15	100%	54	3.6	Integrated
12	4	International Regulatory Environment	14	93%	53	3.8	Situational - E
13	12	Critical but Constructive Culture of Trust	12	80%	51	4.3	Strategic
14	1	Canadian Regulatory Environment	13	87%	45	3.5	Situational - E
15	7	Subsidiary & Main Board Configuration &	11	73%	43	3.9	Situational - I
16	6	Lessons Learned	12	80%	43	3.6	Situational - E
17	10	Global Integration and Local Response	9	60%	36	4.0	Situational - I
18	9	Organizational Complexity	12	80%	36	3.0	Situational - I
19	18	Good CEO (Stewardship Theory)	13	87%	32	2.5	Integrated
20	14	Effective Chair	11	73%	31	2.8	Strategic
21	8	Degree of Internationalization	9	60%	30	3.3	Situational - I
22	3	International Environment:	11	73%	23	2.1	Situational - E

(Source: Own Design)

Appendix 13: Research Sub-Categories Sorted by # Citations – pg. 1

Rank	Category	Sub-Category	Chairman	Director	CEO	CRO	Canadian Expert	Foreign Expert	Totals:	Cited %	Hilb Principle
		Total Interviewees:	3	3	2	2	3	2	15		
						Number of Citations					
1	17	Integrated Boards & Mgmt	14	10	10	8	6	3	51	340%	Integrated
2	20	Risk Management & Diligence	10	12	3	11	4	5	45	300%	Control
3	17	Integrated Board Governance	10	10	3	12	5	4	44	293%	Integrated
4	17	Integrated HQ & Subsidiaries	10	9	4	6	7	7	43	287%	Integrated
5	20	Risk Measures & Controls	8	12	7	8	1	6	42	280%	Control
6	17	Integrated Sub. Governance	10	11	4	5	6	4	40	267%	Integrated
7	13	Strategic Issues	6	7	4	5	8	5	35	233%	Strategic
8	21	Good Controls	6	3	7	9	4	1	30	231%	Control
9	16	Strategic Renewal	3	3	4	5	9	5	29	207%	Integrated
10	22	Effective Exchange/Decisions	7	5	5	2	1	3	23	192%	Control
11	22	Good Teamwork	4	5	4	5	1	1	20	167%	Control
12	19	Culture as Management Tool	7	2	4	4	4		21	162%	Integrated
13	13	Focus on Strategy	5	6	4	3	4	2	24	160%	Strategic
14	13	Importance of International	4	5	4	4	5	2	24	160%	Strategic
15	22	Right People / Leadership	4	4	2	4	4	1	19	158%	Control
16	12	Constructive Engagement	6	2	1	5	3	1	18	150%	Strategic
17	4	Challenges of Integration	4	5	1	3	5	1	19	136%	Situational
18	12	Trusting Board/Mgmt Team	5	2	5	2	2		16	133%	Strategic
19	13	International as diversification	4	4	3	1	4	3	19	127%	Strategic
20	15	Director Selection / Experience	3	2	3	2	6	3	19	127%	Integrated
21	12	Director/Board Effectiveness	5	3	1	3	2	1	15	125%	Strategic
22	19	Mgmt Execution & Control	5	3	2	3	2	1	16	123%	Integrated
23	5	Breakdown / fraud in "Big 5"	3	7	3	2	1	1	17	121%	Situational
24	1	Regulator Meetings/Relations	3	4	1		4	3	15	115%	Situational
25	11	Targeted Skills & Experience	4	3	1	2	4	3	17	113%	Strategic
26	11	Targeted Demographics	4	3	2	1	5	2	17	113%	Strategic
27	10	"Link Pins" & Glocal processes	7	1	1		1	1	11	110%	Situational
28	6	Changed Control Processes	4	6		3			13	108%	Situational
29	18	CEO as Stewart	2	2	4	2	2	2	14	108%	Integrated
30	20	Independence of Audit/Risk	1	3	3	2	3	3	15	100%	Control
31	5	Board / Management failure	2	6	2		3	1	14	100%	Situational
32	6	Recognized "Gaps"	2	3	1	4	1	1	12	100%	Situational
33	14	Facilitates Board Engagement	2	5		1	1	2	11	100%	Strategic
34	8	International strategy	2	1	2	2	1	1	9	100%	Situational
35	8	Control of Subsidiaries	2	2	1	1	2	1	9	100%	Situational
36	20	Risk Planning & Innovations	3	3	2	1	4	1	14	93%	Control
37	16	Board Teams	3	3		3	4		13	93%	Integrated
38	1	Regulation and Pressures	3	4	1		2	2	12	92%	Situational
39	18	CEO as Leader / Innovator	2	4	1	3	2		12	92%	Integrated
40	21	International Controlling	6	3	1	2			12	92%	Control
41	7	Main Board Structure & Skills	5	1	3		1		10	91%	Situational
42	10	Local Effectiveness	3	2	2	1	1		9	90%	Situational
43	2	Few, Large & Diversified Banks	2	1	2	1	6	1	13	87%	Situational
44	20	International Risk Measures	4	1	3	2	1	2	13	87%	Control
45	19	Strong Managers & Teamwork	4	1	2	1	1	2	11	85%	Integrated
46	6	Changed Governance Processe	4			4	2		10	83%	Situational
47	22	Good Information/Planning	2	4	2	1		1	10	83%	Control
48	7	Board Size Matters	2	2	3		1	1	9	82%	Situational
49	14	Governance - gets it done	1	3	1	1	1	2	9	82%	Strategic
50	13	Execution of Strategy	3	1	2	4		2	12	80%	Strategic
51	15	Board Development/Renewal	3	2	2		5		12	80%	Integrated
52	5	Breaches in other companies	2	2	2	2	2	1	11	79%	Situational
53	8	Hierarchy of Subsidiaries	3	1	1	1		1	7	78%	Situational
54	22	Board/Committee Renewal	3	3	1	1	1		9	75%	Control
55	11	International Skills	2	4			3	2	11	73%	Strategic
56	5	Reason for breakdown	2	2	2	2	2		10	71%	Situational
57	21	Communication Function	3	1		4	1		9	69%	Control
		(Continued on Page 2)									

(Page 2 … continued)

Appendix 13: Research Sub-Categories Sorted by # Citations – pg. 2

			Chairman	Director	CEO	CRO	Canadian Expert	Foreign Expert	Totals:	Cited %	
Rank		Total Interviewees:	3	3	2	2	3	2	15		**Hilb**
	Category	Sub-Category			Number of Citations						Principle
58	2	Each Bank Seeks Excellence	1	1	1		6	1	10	67%	Situational
59	2	Canadian & Bank Culture			1	1	5	3	10	67%	Situational
60	11	Targeted Board Roles	4	1	2		3		10	67%	Strategic
61	20	Auditing Function of the Board	2	1	2		1	4	10	67%	Control
62	10	Business/Product Complexity	1	1	2	2	1	1	8	67%	Situational
63	4	Int'l Regulation & Weaknesses	4	3	1			1	9	64%	Situational
64	21	Holistic Perspective	2	3			2	1	8	62%	Control
65	2	Stakeholder & Public Pressure	1	4	1		3		9	60%	Situational
66	11	Conflict of Board Size & Skills	2	2	1	1	2	1	9	60%	Strategic
67	15	Director Time	3	1		2	2	1	9	60%	Integrated
68	15	International Skills & Subs	2	1			4	2	9	60%	Integrated
69	10	Global Standards	1	2	1	1	1		6	60%	Situational
70	9	Complex / matrix organizations	1	1		4	1		7	58%	Situational
71	9	International Complexity	3	1	1	2			7	58%	Situational
72	22	Focus on Priorities	2	2			1	2	7	58%	Control
73	4	Int'l Regulatory over-reaction	2	1	1	1	2	1	8	57%	Situational
74	16	Individual Directors	2			1	4	1	8	57%	Integrated
75	16	Entire Organization	1	2		1	4		8	57%	Integrated
76	16	International subsidiaries	1	2		2	1	2	8	57%	Integrated
77	8	Structure of Subsidiary Board	2	1		1		1	5	56%	Situational
78	3	Optimizing Subsidiary Boards	2	2		1	1		6	55%	Situational
79	7	Local Directors / Advisors	1	1		2	1	1	6	55%	Situational
80	7	Issues / Difficulties	2			2		2	6	55%	Situational
81	14	Chair as Innovator/Leader		1	1		2	2	6	55%	Strategic
82	1	Higher Capital/Basil Rules	1	2			3	1	7	54%	Situational
83	1	Mortgage & other Laws	3	2	1			1	7	54%	Situational
84	19	Mgmt Foresight & Diligence	1	2		2	2		7	54%	Integrated
85	19	Glocal Mgmt & Processes	1	2	1	2	1		7	54%	Integrated
86	2	Mortgage Environment	2	2	1	1	1	1	8	53%	Situational
87	2	Industry Seeks Improvements	2	1	1		3	1	8	53%	Situational
88	4	Impact on Subsidiaries/Boards	1	2		2	2		7	50%	Situational
89	10	Subsidiary Board / Controls	3		1			1	5	50%	Situational
90	10	Challenges of being Glocal	2	1		1	1		5	50%	Situational
91	3	Harmonization & Complexity		2	1		1	1	5	45%	Situational
92	3	International Differences			1	1	1	2	5	45%	Situational
93	7	Directors on Subsidiary Boards	3			2			5	45%	Situational
94	6	Review other banks / Lessons		3	1			1	5	42%	Situational
95	9	Complex Board Expertise	1		1	1	1	1	5	42%	Situational
96	9	Regulatory complexity	2	1	1		1		5	42%	Situational
97	3	International Banking Crisis			1		2	1	4	36%	Situational
98	7	Management on Sub Boards	1		1	2			4	36%	Situational
99	4	Working with Int'l Regulators	2		1		1	1	5	36%	Situational
100	4	New Global Regulation	1	1	1		2		5	36%	Situational
101	5	Reaction to breakdown	2	1		1		1	5	36%	Situational
102	2	Canadian Economy	1		1	1	1	1	5	33%	Situational
103	15	Board Evaluation & Feedback	1	2	2				5	33%	Integrated
104	9	Complexity of Controls	1			2	1		4	33%	Situational
105	18	Issues of Dominant CEO	1			1	1	1	4	31%	Integrated
106	3	International Best Practices			1		1	1	3	27%	Situational
107	7	Regulator Impact	1		1			1	3	27%	Situational
108	14	Chair as Coach / Management		1		1		1	3	27%	Strategic
109	6	Brought in Outside Consultant	3						3	25%	Situational
110	21	Evaluation of the Board	1				2		3	23%	Control
111	14	Chair - focus on Stakeholders				1		1	2	18%	Strategic
112	12	Make Decisions	2						2	17%	Strategic
113	1	Total Bank Focus	1				1		2	15%	Situational
114	18	CEO Skills / International		1				1	2	15%	Integrated
	114		328	282	175	211	240	147	1383		

(Source: Own Design)

Curriculum Vitae

THOMAS C. SEARS

243 Ward St. Port Hope, Ontario CANADA L1A 4A4 – (416) 409-3441 – Tom.Sears@Rogers.com

Date of Birth: July 9, 1950, Montreal, Quebec, Canada
Marital Status: Married for 32 years to Jessica, 4 Children
Citizenships: Canadian, Irish
Personal Interests: Family, Community Involvement, Lecturing, Travel, Music, Golf,

Awards and Honours:

2012 – Governor General's Medal – for service to Canada in International Business
2010 – Permanent Honourary Member – Royal Commonwealth Society – Barbados Branch
2002 – Permanent Honourary Trustee – Wildlife Preservation Trust of Canada
1992 – Arbor Award for Volunteerism – University of Toronto

EMPLOYMENT HISTORY:

January 1, 2010 – Present

International Business Advisor, Lecturer & Doctoral Candidate
Chairman – Barbados International Business Association (Canada)
Sr. Advisor – Centre for Trade Policy & Law (Carleton U. & U. of Ottawa)
Lecturer – University of Toronto (Rotman School of Management)
PhD Candidate - research in Corporate Governance – St Gallen Univ.

1975 to 2009 – RBC FINANCIAL GROUP of Companies (Retired Dec 31st, 2009):

June 2002 – Dec 2009

Chairman & CEO, Royal Bank of Canada Insurance Company
Barbados – Head of RBC's Reinsurance operations in Barbados
– Board Director of several RBC international subsidiaries
– Responsible for RBC Insurance Rep Offices in Beijing & Mumbai

August 2000 – June 2002

Managing Director, Global Private Insurance, RBC Insurance
Toronto – Head of Global Private Insurance & Insurance Wealth Management
– Head of Global Private Banking Acquisitions & Strategic Initiatives

March 1996 – August 2000

Managing Director and VP, RBC Jersey (Channel Islands)
Channel Islands – Head of RBC's largest Private Banking operations
– Board Director of many RBC and client companies
– Oversight of Tokyo Office; Global Head of Trust

Sept 1994 – March 1996

Managing Director, Global Custody (GSS, London, England)
London, England – Head of Global Custody & Securities Services

May 1993 – Aug 1994

Royal Bank / Royal Trust Merger
Toronto – Task Force Co-chair & Head of Client Integration & Retention

Dec 1975 – May 1993

Other RBC & Royal Trust roles (Montreal, Ottawa & Toronto):

- General Manager. The R-M Trust Company (now "CIBC Mellon")
- Vice President, Corporate Trust
- Director, Pension Trust Operations
- Sr. Manager. Banking Systems Development; Methods Analyst

Curriculum Vitae – Page 2:

PERSONAL INFORMATION:

EDUCATION:

2007	PhD Candidate, International Business – St Gallen University, Switzerland
1988	Master of Business Administration (Dean's List), University of Toronto
1979	Canadian Securities Course
1974	Bachelor of Arts, Concordia University, Montreal, Quebec

INDUSTRY & COMMUNITY INVOLVEMENT :

Chairman, Canada-Barbados International Business Association (in Canada), 2010 – Present
Northumberland Hills Hospital, Cobourg Ont., Board of Directors, Audit & Governance Committees - 2010
Royal Canadian Golf Association, Governance Committee, Jan 2010 - Present
Royal Commonwealth Society (Barbados Branch), Councillor, 2007-2009; Permanent Trustee: 2010 – Present
Trinity College School, Port Hope, Buildings and Infrastructure Committee, Sept 2009 – Present
Securities & Investment Institute (London, UK) – Fellow, 1998 – Present;
Member, Institute of Directors (London, UK), 1998 – Present.
Member, Institute of Corporate Directors (Canada), 2011 - Present
Wildlife Preservation Trust of Canada, Vice President, 2000 – 2002; Permanent Honorary Trustee, 2002 – Present
University of Toronto – Rotman School of Management (1989 – Present):

- Lecturer – MBA and Executive Programmes, 2008 - Present
- Arbor Award Winner (for outstanding Voluntary Services), 1992
- Dean's Advisory Council, 1991 – 1992
- President, UofT MBA Alumni Association, 1990 – 1991
- Director, UofT Alumni Association, 1990 – 1991
- Director, UofT MBA Alumni Board, 1989 – 1992

Previous Volunteer Roles:

Barbados International Business Association, President, Board Director & Member: 2002 - 2009;
Royal Westmoreland Golf Club - Board of Governors, March 2007 – July 2009
Barbados Ministry of International Business, Advisory Board, May 2004 – 2008
University of West Indies (Cave Hill) – Lecturer, MSc Programme, International Business, 2008
Royal Commonwealth Society (Barbados Branch), Councillor, 2007 – 2009
Barbados International Insurance Association, Chairman, 2003 – 2005
Invest Barbados, Board Director, 2006 - 2007
Wildlife Preservation Trust of Canada, Board Member & VP, 2000 – 2002, Honorary Trustee, 2002 – Present
Hautlieu School, Jersey (Channel Islands), Governor and Board Trustee, 1997 – 2000
Durrell Wildlife Conservation Trust (Jersey), Gardien, 1996-2000
Airports & Harbours Commission, States of Jersey, Executive Advisor, 1999
Boys Scouts of Canada, Greater Toronto Area, **Chairman of Camping,** 1996 – 1997
Junior Achievement of Canada, Presenter and School Leader, 1989