

A Director's Guide to EXECUTIVE COMPENSATION

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Executive Compensation Updates

The ever-evolving world of executive compensation is evolving yet again. This issue provides an overview of the key changes to the executive compensation disclosure rules proposed by the Canadian Securities Administrators (CSA). This issue also outlines the results of the CSA's corporate governance review. It further includes updates from the Toronto Stock Exchange (TSX), the Canadian Coalition for Good Governance (CCGG), Institutional Shareholder Services Inc. (ISS) and Mouvement d'éducation et de défense des actionnaires (MEDAC).

CSA Proposed Disclosure Rules

On November 19, 2010, the CSA proposed changes to the executive compensation disclosure form, Form 51-102F6 Statement of Executive Compensation (Proposed Changes).¹ The period for commenting on the Proposed Changes is open until February 17, 2011.

Having completed two proxy seasons under the disclosure rules introduced on December 31, 2008, the CSA has had the opportunity to assess the compliance of reporting issuers with those rules and propose some amendments, as described below. The Proposed Changes

are intended to enhance the information provided to investors and assist companies in meeting their executive compensation disclosure obligations. The Proposed Changes assumed that the amendments published by the CSA on October 1, 2010 to address the changeover to the International Financial Reporting Standards (IFRS) obtained the required provincial approvals and came into effect on January 1, 2011.² The Proposed Changes, if adopted, would apply to reporting issuers with fiscal years ending on or after October 31, 2011.

The Proposed Changes follow developments in executive compensation in the United States. On December 16, 2009, the Securities and Exchange Commission (SEC) amended the compensation disclosure requirements for issuers in the U.S. to require them to provide more information about risk analysis, the grant date fair value of equity-based awards and the services supplied by compensation advisors. Further, the *Dodd-Frank Wall Street Reform and Consumer Protection Act* was signed into law on July 21, 2010 and includes provisions that will affect corporate governance practices. The CSA took into consideration the developments in the U.S. that were rele-

These quarterly newsletters provide practical advice and current legal comments on executive compensation and compensation governance and disclosure. These newsletters will be of interest to directors, executives, lawyers and human resources professionals.

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From the Editor

This issue provides an overview of several recent developments in executive compensation. The fact that so many developments have arisen emphasizes the continuously evolving nature of executive compensation. It also emphasizes how important it is for those who practice in this area to remain current.

— Nadine Côté LL.B.

vant to Canadian reporting issuers and developed the Proposed Changes. The following describes the key substantive provisions of the Proposed Changes.

Serious Prejudice Exemption

Currently, the Compensation Discussion and Analysis (CD&A) section of Form 51-102F6 requires companies to disclose any specific performance goals or similar conditions pertaining to executive compensation, unless the disclosure would seriously prejudice the company's interests. On reviewing the executive compensation disclosure of reporting issuers, the CSA Staff noticed that it was difficult to determine when companies were relying on the "serious prejudice" exemption.³ As such, under the Proposed Changes, companies would be required to explicitly state when they are relying on the exemption and explain how the company's interests would be seriously prejudiced if the relevant performance goals or similar conditions were disclosed.

Risk Management

The disclosure changes recently introduced by the SEC included the requirement to disclose the company's compensation practices and policies for all employees if they create risks that are reasonably likely to have a material adverse effect on the company. Similarly, the Proposed Changes would broaden the scope of the compensation disclosure requirements to include the disclosure of whether the board of directors considered the risk implications of the company's compensation practices and policies. If a risk analysis was done, the company would also be required to disclose its compensation practices and policies for named executive officers (NEOs) and individuals at a principal business unit or division if the risks arising from those practices and policies would be reasonably likely to have a material adverse effect on the company.

Disclosure of Hedging

Aligning the interests of executives

with those of the company is one of the purposes commonly cited for granting executives equity-based incentives. This purpose could be defeated if executives were permitted to purchase financial instruments designed to hedge or offset the risks associated with holding equity-based awards granted by the company.

The Proposed Changes would require companies to disclose whether the NEOs or directors are permitted to purchase financial instruments designed to hedge or offset a decrease in the value in their equity-based securities granted as compensation or held, directly or indirectly, by the NEOs or directors.

Disclosure Relating to Consultants

In recent years, concerns were raised that compensation consultants were in a conflict of interest when providing compensation advice to boards while also providing more extensive advice to management for relatively greater fees. In these circumstances, it was alleged the advice provided to boards would be favourable to management so that management would continue to retain the consultants on their broader, more significant fee based engagements.

The Proposed Changes would introduce a new requirement to disclose the terms of engagements with compensation consultants in the CD&A, as well as broadening this disclosure in National Instrument 58-101 Disclosure of Corporate Governance Practices. Consequential amendments would be made to Form 58-101F1 and Form 58-101F2 to permit companies to incorporate by reference the compensation governance disclosure in the CD&A into these forms.⁴

Summary Compensation Table

Currently, the disclosure rules permit companies to add tables, columns and other information, if necessary, to satisfy the objectives of executive compensation disclosure. On reviewing the summary compensation table (SCT) of reporting issuers, the CSA Staff noticed

that some companies relied on this provision to present the SCT in a format different from that required by the rules.⁵

The Proposed Changes would restrict companies from altering the format of the SCT by adding columns or other information. The commentary would provide that companies may add another table and other information so long as the additional information would not detract from the SCT required by the rules.

CSA Corporate Governance Review

On December 2, 2010, the CSA published the results of its corporate governance disclosure review.⁶ The CSA reviewed 72 reporting issuers for compliance with National Instrument 58-101 Disclosure of Corporate Governance Practices and the related policy. The review found that 55 per cent of reporting issuers reviewed were required to make prospective enhancements to their governance disclosure, up from 36 per cent in a similar review in 2007. Areas for improvement included:

- Director independence
- Position descriptions
- Orientation and continuing education
- Codes of ethical business conduct
- Nomination of directors
- Assessment of directors

The notice provides guidance on compliance with these disclosure requirements, along with the disclosure requirements for risk oversight and management.

TSX Updates

Stock Option Plans

On November 12, 2010, the TSX issued Staff Notice 2010-0002 regarding the stock option plans and arrangements that may be affected by the tax changes proposed in the Federal Budget of March 4, 2010.⁷ The tax changes were described in the September 2010 Newsletter.

The TSX indicated it will generally consider amendments to stock option

plans and arrangements to address the tax changes proposed by the recent Federal Budget to be of a "housekeeping" nature. Housekeeping amendments can usually be done with the approval of the board of directors and without the approval of shareholders. Still, these amendments must be: (1) reviewed and pre-cleared by the TSX; and (2) disclosed annually to shareholders.

The TSX will permit a listed issuer to amend its stock option plan and arrangements, notwithstanding the plan or arrangement does not have the proper amendment provision required by Staff Notice 2006-0001, provided that: (1) the amendment is limited to compliance with the changes in the Income Tax Act (Canada) proposed by the recent Federal Budget; (2) the issuer adopts a proper amendment procedure in the plan and arrangements; and (3) the amendment procedure is approved by security holders at the next meeting.

Personal Information Form & Declaration

On December 7, 2010, the TSX issued

Staff Notice 2010-0003 regarding the new procedures imposed by the Ontario Provincial Police (OPP) that impact the filing and processing of Form 4 - Personal Information Form (PIF) and the Statutory Declaration (Declaration). The Staff Notice indicates that the TSX must collect two pieces of identification when requesting a criminal record check from the OPP. As such, applicants must submit two pieces of photocopied and verified identification with their PIF or Declaration effective January 1, 2011.⁸

CCGG, ISS & MEDAC Updates

CCGG Updates

In November 2010, the CCGG released its 2011 Board Engagement Strategy. CCGG indicated it intends to meet with approximately 45 to 50 companies in 2010-2011 to:

- Establish a relationship with the board to open dialogue on governance matters
- Discuss the board's approach to executive compensation relative to CCGG's

principles

- Discuss any recommended governance practices not followed at companies
- Discuss the board's risk oversight, including risk disclosure and links to compensation
- Provide CCGG members with information to assist them in making investment and voting decisions⁹

In December 2010, the CCGG published its 2010 Principles of Governance Monitoring, Voting and Shareholder Engagement. The policy outlines the following principles and best practices for Canadian institutional investors:

- Monitor investee companies
- Exercise voting rights
- Engage with investee companies on governance matters
- Monitor and engage with regulators and policy makers
- Provide transparency of voting and engagement practices¹⁰

ISS update

On November 19, 2010, ISS, now a subsidiary of MSCI Inc., released its Canadian Corporate Governance Policy

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Salary surveys challenging but crucial tool in tight market
Companies rely on surveys for attraction and retention strategies but complicated compensation packages threaten to compare
BY SARAH DOBSON

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"You may throw out your pay scales and be fighting for years to get them back to a normal position."
they provide a snapshot of what's happening or emerging in the marketplace as organizations cut across year-to-year or even month-to-month changes.
In pressure regions such as Alberta, employees use these surveys to better understand how quickly budgets need to be adjusted to stay competitive and attract top talent.
"These situations can happen at any time of the year so it helps to have good market data to understand the range of pay that's out there," says Danielle Bushen, national market leader for information product solutions at Mercer Human Resource Consulting in Toronto.
Similarly, when it comes to retain-

ing employees, the data assists a company in gauging its pay relative to the market by benchmarking a cross-section of jobs. More companies are also giving mid-year increases in compensation so timely results are often needed.
But Carolyn McKnight, manager of surveys at management consulting firm Hay Group in Toronto, says it can be difficult to get accurate data in really hot markets when so one wants to share their secrets. She cautions against reacting too quickly to every thing.
"You may throw out your pay scales and be fighting for years to get them back to a normal position. A lot of these things won't last," says McKnight. "You have to balance the two — get the people you want but don't mess up everything you have going because you spend a lot of time setting up pay scales that make sense."
So how are salary surveys changing with the times?
Long-term incentives
As compensation packages continue to evolve and become more complex, surveys are providing a better understanding of the details and value of long-term incentives such as profit sharing and stock options.
These are just as important as base salary, says Gail Evans, president of Wynford Group in Calgary, a management consulting firm.

"We're seeing a lot more use of incentives, short-term and long-term, for key positions," she says, and companies are keen to learn more about the philosophies or policies of other organizations through survey results.
Targets versus actuals
Companies are also taking a better look at target levels (prospective pay) and actual annualized payments (salary and bonus given out at the time of the survey). When the two are different, it's a matter of looking at the previous year to understand the performance of the company, the individual or the market, says Bushen.
"In aggregate, if it looks like the actuals are below target that would suggest it hasn't been a great year in the economy. If payouts are generally a lot higher, it's been a good year and employees are reaping the benefits and payouts are actually much higher than employers had planned," she says. "So those are very useful tools."

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- 2011 Updates.¹¹ The policy sets out ISS's recommended voting approach to the following corporate governance issues:

- Independent boards and compensation committees
- Equity-based compensation plans
- Articles of incorporation and bylaws
- Poison pills (shareholder rights plans)

MEDAC Update

MEDAC released its 2011 shareholder proposals in French.¹² MEDAC indicated it will make the following proposals related to compensation and governance.

Equity ratio. Boards of directors should adopt a policy requiring the

ratio of the total compensation of the senior executives compared to the median total compensation of employees be ethically reasonable, considering the contribution employees make to the success of the senior executives and the company. Total compensation includes salary, bonus, long-term incentives and retirement benefits. MEDAC noted that the CEO-to-worker compensation ratios among the banks varied from a reasonable 28:1 to an unreasonable 156:1.

Gender-balanced boards. Boards of directors should adopt a policy requiring gender-balanced boards within 10 years. MEDAC noted that companies whose boards included women members

performed better financially and from a governance perspective and were better perceived by investors.

Peer group comparators. Compensation committees should provide shareholders with more information about its use of peer group comparisons in determining the compensation of executives and the importance placed on the peer group comparisons. MEDAC noted that research has shown the disclosure of executive compensation has contributed to its continuous rise. It has further been shown that organizations using peer group comparisons tend to select peers whose executive compensation is greater than that provided by the company.

This newsletter reflects the views of the author(s) and is provided only for informational purposes. It does not constitute legal, tax, accounting, compensation consulting or other professional advice and cannot reasonably be relied upon as providing such advice. Your inquiries on these matters may be directed to Nadine Côté at ncote@bell.blackberry.net.

¹ Notice and Request for Comment - Proposed Amendments to Form 51-102F6 *Statement of Executive Compensation* and Consequential Amendments (2010) 33 O.S.C.B. 10723 (19 November 2010).

² Notice of IFRS-Related Amendments to National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards* and Certain Other Instruments (2010) 33 O.S.C.B. (Supp-3) (1 October 2010).

³ CSA Staff Notice 51-331 *Report on Staff's Review of Executive Compensation Disclosure* (2009) 32 O.S.C.B. 9599 (20 November 2009) [CSA Compensation Review].

⁴ National Instrument 58-101 *Disclosure of Corporate Governance Practices* (2005) 28 O.S.C.B. 5377, as am.

⁵ CSA Compensation Review, *supra* note 3.

⁶ CSA Staff Notice 58-306 2010 *Corporate Governance Disclosure Compliance Review* (2 December 2010), online: http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20101203_58-306_2010-corp-gov-disclosure.htm.

⁷ Toronto Staff Exchange Staff Notice 2010-0002 (12 November 2010), online: http://tmx.complinet.com/en/display/display.html?rbid=2072&element_id=756.

⁸ Toronto Stock Exchange Staff Notice 2010-0003 (7 December 2010), online: http://tmx.complinet.com/en/display/display.html?rbid=2072&element_id=757.

⁹ CCGG 2011 Board Engagement Strategy, online: http://www.ccg.ca/site/ccgg/assets/pdf/2011_Board_Engagement_Strategy.pdf.

¹⁰ CCGG 2010 Principles of Governance Monitoring, Voting and Shareholder Engagement, online: http://www.ccg.ca/site/ccgg/assets/pdf/Principles_for_Governance_Monitoring_Voting_and_Shareholder_Engagement-Formatted__2_.pdf.

¹¹ ISS Canadian Corporate Governance Policy - 2011 Updates, online: <http://www.issgovernance.com/files/ISS2011CanadianPolicyUpdates20101119.pdf>.

¹² MEDAC Propositions aux assemblées des actionnaires 2011, online: http://medac.qc.ca/documentspdf/actionnariat/propositions_2011.pdf

A comprehensive review of executive compensation in Canada is available in the regularly updated loose-leaf book published by Carswell, a Thomson Reuters business, titled "*Executive Compensation: A Director's Guide*" by Nadine Côté.