

A Director's Guide to EXECUTIVE COMPENSATION

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EVENTS

Disclosure – Getting it Right

Finally, a Summary of the Compensation Disclosure Obligations

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.



Nadine Côté is an employment lawyer, executive compensation consultant and author of *Executive Compensation: A Director's Guide*, the first comprehensive book in Canada on executive compensation.

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Sources of Disclosure Obligations

There are numerous sources of compensation, governance and insider reporting and disclosure obligations with which organizations, directors and executives must comply. These obligations are derived from provincial securities laws and regulations imposed by governments, national and multilateral instruments adopted by provincial securities regulators and the Canadian Securities Administrators (CSA), and requirements instituted by stock exchanges for organizations listed on their exchanges. It may seem difficult to understand all of the disclosure obligations because each government, securities commission and stock exchange can establish its own set of rules independent from one another and they are not all published in one location.

This newsletter brings together the various sources of disclosure obligations to provide a general framework for understanding the overall requirements. This will assist boards of directors, com-

penensation committees, executives and human resources professionals in understanding their reporting and disclosure obligations. Certain aspects of compensation disclosure and insider reporting of equity-based compensation grants were set out in our prior newsletters dated September 2006 and February 2008. The following is a very brief refresher of those obligations and overview of the other disclosure and reporting obligations. A detailed analysis of the compensation disclosure and reporting obligations is set out in the book I authored, which is associated with this newsletter titled "Executive Compensation: A Director's Guide".

Heads-up – our next newsletter will provide a comprehensive review of the liability concerns that arise when the reporting and disclosure go wrong. An understanding of the consequences of failing to satisfy the reporting and disclosure obligations emphasizes the importance of ensuring proper attention and resources are directed to getting the disclosure right at the outset.

From the Editor

I am pleased to be the new General Editor of these newsletters and welcome you to our improved format. In our new format, I will continue to provide practical advice and legal commentaries on executive compensation. As a new feature, from time to time, comments, opinions and interviews with other executive compensation specialists will be included. This issue includes comments from Hugessen Consulting Inc., a specialized compensation consulting firm providing advice to boards of directors and compensation committees in Canada and the United States. Hopefully, you will find the new format interesting and your comments and ideas for topics are welcomed at ncote@bell.blackberry.net.

— Nadine Côté LL.B.

Executive Compensation Disclosure

The most detailed executive compensation disclosure obligations are set out in National Instrument 51-102 – Continuous Disclosure Obligations.¹ NI 51-102 applies to issuers, other than investment funds, that are reporting issuers in one or more jurisdictions in Canada. NI 51-102 is accompanied by a companion policy, Companion Policy 51-102CP – Continuous Disclosure Obligations, which clarifies how provincial and territorial authorities interpret and apply certain of its provisions.²

Pursuant to NI 51-102, reporting issuers must file on an annual basis certain continuous disclosure documents, including Form 51-102F6 – Statement of Executive Compensation.³ The Statement of Executive Compensation sets out various compensation charts that must be completed, along with the narratives and reports that must be provided. Much of the information that is required to complete the Statement of Executive Compensation applies to a reporting issuer's "named executive officers". Currently, the named executive officers are:

- The chief executive officer.
- The chief financial officer.
- Each of the organization's three most highly compensated executive officers, other than the CEO and CFO, who were serving as executive officers at the end of the most recently completed financial year and whose total salary and bonus exceeds \$150,000.
- Any additional individuals for whom disclosure would have been provided under the third category above, except that the individual was not serving as an officer of the organization at the end of the most recently completed financial year.⁴

The charts that must be completed in respect of the compensation of the named executive officers currently include:

- A summary compensation table, which sets out the annual salary, bonus, other annual compensation, long-term compensation awards and all other compensation, including perquisites.
- A chart for the long-term incentive plan awards that were granted.
- A chart for the options and share

appreciation rights that were granted.

- A chart for the aggregate options and share appreciation rights exercised and their year-end values.
- A pension plan table.
- An options and share appreciation rights re-pricing table.

The Executive Compensation Form also requires the disclosure of the terms and conditions of employment contracts, termination agreements and change-of-control agreements for named executive officers. The composition of the compensation committee must be disclosed, along with a report on the organization's compensation practices. Finally, the form requires the disclosure of the compensation arrangements with directors of the reporting issuer.

Status of the Proposed Changes to the Form

The CSA has proposed significant changes to the Executive Compensation Form. The first proposal was released for comments in March 2007 with a deadline for comments in June 2007. The comments received from lawyers, executive compensation specialists and other interested parties were so extensive that the CSA re-released a new version of the proposed amendments in February 2008 with a deadline for comments in April 2008. It is expected that a revised Executive Compensation Form will be in effect for organizations with financial years ending on or after December 31, 2008. It is hoped that the new form will provide meaningful, comprehensive compensation analysis and disclosure, without unnecessary valuation costs for items such as pensions and equity-based compensation. In the interim, organizations should ensure that they allot sufficient time to prepare their compensation disclosure when the new form takes effect because it will likely take more time than in the past to complete.

Compensation Governance Disclosure

An issuer must disclose the information required by Form 58-101F1 – Corporate Governance Disclosure, in its management information circular, if the management of the issuer, other than a venture issuer, solicits its proxy from a

security holder of the issuer for the purpose of electing directors. The Corporate Governance disclosure includes a section on compensation governance.⁵ The compensation governance that is required to be disclosed pursuant to this form includes:

- A description of the process used by the board to determine the compensation of directors and officers.
- A description of the compensation committee's independence, responsibilities, powers and operations, if there is a compensation committee.
- A description of any compensation advisor's that were retained, along with a description of the advisor's mandate and any other services provided by the advisor.
- A description of the process used to assess the effectiveness and contribution of the board, its committees and directors.

Prospectus Disclosure

If an issuer files a prospectus, the issuer must disclose the information required by Form 41-501F1 – Information Required in a Prospectus.⁶ In terms of the compensation disclosure required by this form, item 18 requires the disclosure of the indebtedness, other than routine indebtedness, of each director and officer of the issuer.

Equity-Based Incentive Plan Disclosure

Organizations that issue securities on the Toronto Stock Exchange (TSX) must comply with the disclosure requirements of the TSX Company Manual.⁷ The TSX Company Manual includes compensation disclosure requirements in respect of the implementation of and certain amendments to security-based compensation arrangements. Specifically, a listed issuer that provides materials to security holders in respect of a meeting to obtain their approval for the implementation of or certain amendments to a security-based compensation arrangement, must pre-clear such materials with the TSX and disclose in the materials various aspects of the arrangement, including:

- The eligible participants under the arrangement.

- The total number of securities issued and issuable under the arrangement.
- The maximum percentage of securities, if any, available to insiders of the issuer under the arrangement.
- The exercise price, the vesting requirements and the term of any stock options.
- The procedure for amending the arrangement.

Insider Reporting Obligations

Insider Profiles

Insiders of an organization can have various reporting and disclosure obligations. Insiders can generally be described as: the directors and officers of the organization, its subsidiaries and an organization that itself is an insider; those who own at least 10 per cent of the voting shares of the organization; and, organizations that purchase or redeem their own securities.⁸

Insiders of reporting issuers are required to file insider profiles. Insider profiles are forms setting out basic contact information of the insider, along with the insider's relationship to the reporting issuer and the date he or she became an insider.⁹

Insider Reports of Changes in Securities

Insiders are also required to file insider reports within 10 days of becoming an

Question and Answer with Hugessen Consulting Inc.

Q: Hugessen Consulting Inc. commented extensively on the new executive compensation rules proposed by the CSA. In your opinion, did the revised proposal released in 2008 address the comments the CSA received on the first proposal released in 2007 and will the revised proposal be effective?

A: In our view, the CSA has done an excellent job of addressing the most significant comments made by Hugessen and others on the 2007 Proposal while maintaining its commitment to a concise, principles-based set of rules, that we believe, will improve the quality and transparency of executive compensation disclosure.

Q: I noticed your comments on the disclosure of the long-term cash plans that were provided on the CSA's 2007 proposal were reiterated in your comments on the 2008 proposal, suggesting some significance to these comments. Could you explain those comments?

A: We would reiterate from our earlier comment letter on the 2007 Proposal that long-term cash plans that are not equity-based should be treated on essentially the same basis as equity plans and the estimated grant date value disclosed in the SCT [summary compensation table] in the year of grant, rather than in the year of vesting or payout. This change would lead to a more accurate picture of the intended value of compensation granted in any particular year and make year over year comparisons more meaningful. By not requiring an estimated value in the SCT as of grant date, disclosure in the SCT is delayed until an actual payout, with the result that the SCT is incomplete and could, in fact, be misleading. While we do not see a large number of long-term cash incentive plans currently being used, the proposed delayed disclosure of such plans in the SCT could have the unintended consequence of encouraging the use of such plans more widely in the future.

Thanks to Ken Hugessen, President and Catherine McCall, Principal of Hugessen Consulting Inc. for their contribution to this newsletter. Hugessen Consulting Inc. is a specialized compensation consulting firm providing advice to boards of directors and compensation committees in Canada and the United States.

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ROI of wellness programs imprecise but improving

More companies involved but many not measuring results

BY SARAH DOBSON |

FROM ON-SITE fitness centres to loyalty tracks to newsletters, wellness programs vary widely in scope, cost and commitment. And studies show more companies are getting involved in these initiatives.

But how successful are they in making an impact? According to a 2006 survey of wellness programs in the United States and Canada by the International Federation of Employee Benefit Plans (IFEBC), 41 per cent of respondents don't know what advantage their organization derives from wellness programs and 16 per cent don't know the return on investment (ROI) amount for dollars spent.

And a 2006 National Wellness Survey Report by Balfour & Company Worksite Wellness also found only 30 per cent of 512 respondents in Canada evaluate and record the outcomes of their wellness efforts.

But HR may need more convincing, judging by the results of a study released in May that looked into the motivation behind the implementation of workplace health programs and found finance departments feel a greater moral responsibility than HR, which is more concerned about the bottom-line. (The study was released by the University of Western Ontario's Richard Ivey School of Business in London, Ont., and the University of Lethbridge in Lethbridge, Alta.)

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President of the Ottawa Region Rewards Association **8**

Court clarifies surplus assets

Company allowed to pay expenses from pension fund

IN KERRY (Canada) v. Ontario (Superintendent of Financial Services), Ontario's Court of Appeal has made several major rulings on pensions.

Kerry, a food supply company based in Woodstock, Ont., set up a defined benefit (DB) pension plan in 1964 that has been in a surplus position for years and members have always received full pension benefits.

In 1985, the employer took contributions holidays and by 2001 had taken holidays of about \$1.5 million. Initially the employer paid all plan expenses but, in 1985, third-party plan expenses were paid from the fund. These were primarily the cost of actuarial, investment management and audit services provided to the plan and added up to about \$856,000.

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insider and within 10 days of any changes in the direct or indirect change in ownership, control or direction over securities of the reporting issuer in which the person is an insider.¹⁰ Insider reports are forms setting out information on the type of transaction being reported, such as the type of security and ownership involved, the number of securities acquired or disposed of, the unit or exercise price, and the opening and closing balance of the securities held by the insider. The insider or insider's agent must certify that the information is true and complete.

There are exemptions from the regular insider reporting requirement, which are set out in National Instrument 55-101 – Insider Reporting Exemptions.¹¹ These include reporting exemptions for directors and officers who do not in the ordinary course have access to material facts or changes before they are generally disclosed to the public, other than the chief executive officer, the chief operating officer and the chief financial officer.¹² As well, an alternate form of insider reporting is available for insiders who participate in certain automatic

share purchase and disposition plans, provided the plan does not permit discrete investment decisions by the insider. The alternate form of reporting enables eligible directors and officers to report their activities in automatic share purchase and disposition plans, on a yearly basis, within 90 days of the end of the calendar year.¹³

Insider Reports of Derivative Transactions

Insiders who are not caught by the insider reporting obligations set out above may, nonetheless, be required to report their activities pursuant to Multilateral Instrument 55-103 – Insider Reporting of Certain Derivative Transactions (Equity Monetization).¹⁴ This instrument provides that insiders must file a report if they enter into an arrangement, the effect of which is to directly or indirectly, alter the insiders' economic interest in a security of the reporting issuer or economic exposure to the reporting issuer. There are exemptions to these insider reporting requirements, such as participation by insiders in compensation arrangements that are dis-

closed in publicly filed documents of the reporting issuer and do not involve discrete investment decisions by the insider.

Press Releases and Material Change Reports

The foregoing disclosure obligations relate specifically to executive compensation and compensation governance matters. In addition to these specific disclosure obligations, securities laws require reporting issuers to publicly release various documents and submit them to the securities commissions as part of their on-going disclosure obligations. These documents include annual information forms, annual financial statements, proxy circulars, press releases and material change reports. Although these documents are not expressly devised for reporting executive compensation matters, in fact, this may occur. Accordingly, any provisions in these documents addressing executive compensation matters should be reviewed by the compensation committee, in addition to the reporting issuer's legal and other professional advisors.

A comprehensive review of compensation disclosure 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.

The book is being re-released and the new updated version will soon be available.

¹ National Instrument 51-102 – *Continuous Disclosure Obligations* (2004) 27 O.S.C.B. 3439 as am. [NI 51-102]

² Companion Policy 51-102 – *Continuous Disclosure Obligations* (2004) 27 O.S.C.B. 3439 as am.

³ Form 51-102F6 – Statement of Executive Compensation as set out in NI 51-102 [Form 51-102F6].

⁴ Form 51-102F6 at s. 1.3.

⁵ Form 58-101F1 – Corporate Governance Disclosure as set out in National Instrument 58-101 – *Disclosure of Corporate Governance Practices* (2005) 28 O.S.C.B. 5377.

⁶ Form 41-501F1 – Information Required in a Prospectus as set out in Ontario Securities Commission Rule 41-501 – *General Prospectus Requirements* (2004) 26 O.S.C.B. 555 5 as am. at item 18.

⁷ Toronto Stock Exchange, TSX Company Manual (Toronto: CCH, 2006) S. 613.

⁸ *Securities Act* (Ontario) R.S.O. 1990, c. S.5, as am., s. 1(1).

⁹ Form 55-102F1 Insider Profile as set out in National Instrument 55-102 *System for Electronic Disclosure by Insiders (SEDI)* (2003) 24 O.S.C.B. 6325 as am [NI 55-102].

¹⁰ *Securities Act*, *supra* note 7 at s. 107; Form 55-102F2 – Insider Report as set out in NI 55-102.

¹¹ National Instrument 55-101 – *Insider Reporting Exemptions* (2005) 24 O.S.C.B. 3025 [NI 55-101].

¹² NI 55-101, *ibid* at ss. 2.1 and 2.2. For further exemptions on insider reporting, see also Companion Policy 55-101CP – Exemption from Certain Insider Reporting Requirements (2005) 24 O.S.C.B. 3028.

¹³ NI 55-101, *ibid* at ss. 5.1 to 5.5.

¹⁴ MI 55-103 Insider Reporting for Certain Derivative Transactions (Equity Monetization) (2004) 27 O.S.C.B. 2631.