A Director's Guide to
EXECUTIVE COMPENSATION

THOMSON CARSWELL

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LEXPERT EVENTS

Good Pay Practices

Interested Stakeholders Weigh-In

In recent months, many interested stakeholders heavily criticized excessive executive compensation schemes and held them at least partially responsible for the economic meltdown in developed countries. Following the mass criticism, interested stakeholders have been commenting on how to improve executive compensation practices to avoid another collapse of the financial markets.

Roger Martin, Dean of the University of Toronto Rotman School of Management has suggested eliminating all stock-based compensation, as it only measures market expectations, not executive performance. Henry Mintzberg, Professor of Management Studies at the Desautels Faculty of Management at McGill University has suggested eliminating all bonuses paid to executives including stock-based bonuses, as the problems associated with them cannot be fixed.[1] Others have suggested alternate performance measures and provided guiding principles for determining appropriate executive compensation structures.

This newsletter outlines some of the approaches to good pay practices suggested by various interested stakeholders. This newsletter also includes a summary of various regulatory updates on matters related to executive compensation.

Corporate Knights' Performance Measures

In our May 2009 issue, we commented on the rising disparity in pay between CEOs and workers in the U.S. The Canadian Centre for Policy Alternatives confirmed a similar trend in Canada, in its recently released report, *A Soft Landing, Recession and Canada's Top 100 Highest Paid CEOs* by Hugh Mackenzie. Pursuant to the report, in 2008, the total average compensation for Canada's highest 100 paid CEOs of $7,300,884 was 174 times greater than the total average Canadian income of $42,305, which was up from 104 in 1998.[2] Moreover, the increase in the 100 highest paid CEOs' average compensation outpaced inflation by 70% from 1998 to 2008; whereas, Canadians earning an average income lost 6% to inflation over the same period.

The rising pay disparity is one of the factors that fuelled the outrage over excessive CEO pay packages in developed countries. Interestingly, this factor was also highlighted in a survey assessing the best corporate citizens. In June 2009, Corporate Knights, the Canadian magazine for responsible business, released its

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 and executive compensation lawyer at Davis LLP and Manulife Financial. She is also the author of *Executive Compensation: A Director's Guide*, the first book in Canada on executive compensation.

General Editor & Author
ncote@bell.blackberry.net

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From the Editor

Several organizations are looking to improve their compensation practices following the criticism they received for their role in the global economic crisis. This newsletter outlines some of the good pay practices being promoted by key industry stakeholders. I am pleased to welcome comments on diversity in the legal profession and the initiatives of A Call to Action Canada in major organizations, by Joy Casey, founder and a senior litigation lawyer.

— *Nadine Côté LL.B.*

Diversity In The Legal Profession

Joy Casey and A Call to Action Canada

The importance and value of diversity and inclusiveness are recognized by most organizations and the business case for diversity has been clearly established. Many companies emphasize that diversity and inclusion are part of their core values and promote their diversity initiatives for staff and, often, for their supply chain.

In spite of the current strong emphasis on diversity, the level of representation of women and minorities at senior levels of management and in professions continues to be a major disappointment. The legal profession is particularly slow in making progress. Although women have made up at least 50% of all law school classes for at least 20 years, and minorities are attending law school in rapidly increasing numbers, their numbers are not reflected at the partnership level in major law firms. Further, the number of women and minorities who choose to leave the profession is significantly disproportionate in comparison to white men.

A new initiative to promote diversity in the legal profession is A Call to Action Canada. It is inspired by the "Call to Action", which was set in motion in 2004 by senior legal officers at several major U.S. companies. A Call to Action Canada is directed to in-house counsel in corporations and in government and provides encouragement and support to in-house counsel in advancing diversity and inclusiveness in the legal profession by:

- Requiring their outside law firms demonstrate true progress in the full participation and advancement of women and minority lawyers within law firms
- Limiting or terminating relationships with outside law firms that demonstrate a lack of commitment to being diverse and inclusive

Canadian corporate counsel are asked to sign A Call to Action Canada's mission statement, pledging their organization's commitment to advocate for diversity. Founding signatories include E.I. DuPont Canada Company, Royal Bank of Canada and Accenture Inc.

A Call to Action Canada also encourages organizations to look for opportunities to direct work to women-owned and minority-owned law firms and to commit a percentage of their budget for outside legal services to such firms. A website is being developed for women-owned and minority-owned law firms as a resource to ensure that organizations can find the right firms to meet their needs.

Joy Casey is a senior litigation lawyer at her firm and a founder of A Call to Action Canada. For more information, please contact Joy Casey at info@acalltoactioncanada.com or go to www.acalltoactioncanada.com.

eight annual ranking of the "Best 50 Corporate Citizens". Its ranking methodology focused on the qualities behind companies with true connections to the people and places they employ, affect and serve. Corporate leaders were viewed as those who concerned themselves with long-term stakeholder value, not just shareholder value, and sustainability in every sense, not just rising quarterly gains. The ranking criteria included a salary ratio comparing the salary of the top-paid employee to the lowest-paid employee, assuming the lowest paid employee's salary at $20,800, based on a rate of pay of $10 per hour, forty hours per week and 52 weeks per year.

Those with the lowest salary ratio factor included:

- Rona Inc. at 22.75
- Hydro-Quebec at 25.94
- Canada Post at 30.85

Those with the highest salary ratio factor included:

- BCE Inc. at 738.73
- Husky Energy Inc. at 1,470.77
- Thomson Reuters Corporation at 1,539.77

The survey also ranked companies by the profits consumed by the compensation paid to the top three highest paid executives. Diverting excessive compensation to just a few executives in relation to the company's earnings was used as a measuring stick because it could suggest conflicts of interest and sub-optimal resource deployment. Based on the S&P/TSX60 companies, the average compensation paid to the top three executives consumed 6.8% of profits.

The factors considered by the survey also included the ratio of pension assets to full-time equivalent employees, C-Suite diversity and C-Suite pay. In assessing C-Suite and board level diversity, based on the S&P/TSX60 companies, 8 companies had no female board members, 42 had no visible minorities or aboriginal board members and none had a female CEO.[3]

Given the foregoing factors were used to measure the performance of these companies, query if they will evolve into new measures for assessing CEO performance. Time will tell whether CEO performance measures will evolve to include:

- Ratio of CEO-to-worker pay
- Per cent of company profits paid to top executives
- NEO diversity – females, visible minorities and aboriginal members

Financial Stability Board Compensation Principles

In April 2009, the G20 leaders agreed to establish a new Financial Stability Board (FSB) with a mandate broader than its predecessor, the Financial Stability Form (FSF). The FSB's mandate includes assessing vulnerabilities affecting the financial system and identifying and overseeing actions to address them, monitoring market developments and reviewing the policy development work of international standard setting bodies.

Recognizing that the compensation practices at large financial institutions was one of the factors which contributed to the recent global financial crisis, the FSF formed a working group in late 2008 to develop sound compensation practices. The FSF Principles for Sound Compensation Practices were released in April of 2009 and their Implementation Standards were released in September 2009 (FSB Principles). Based on the FSB Principles, sound compensation practices include:

- Effective governance of compensation
- Alignment of compensation with prudent risk taking
- Effective oversight and shareholder engagement.[4]

CCGG Compensation Principles

CCGG's 2009 Principles of Compensation

The Canadian Coalition for Good Governance (CCGG) released its 2009 Principles of Compensation. The new principles set out CCGG's views on effective compensation programs that tie executive pay to performance. The new principles are:

- **PRINCIPLE 1** "Pay for performance" should be a large component of executive compensation
- **PRINCIPLE 2** "Performance" should be based on measurable risk adjusted criteria, matched to the time horizon needed to ensure the criteria have been met
- **PRINCIPLE 3** Compensation should be simplified to focus on key measures of corporate performance
- **PRINCIPLE 4** Executives should build equity in their company to align their interests with shareholders
- **PRINCIPLE 5** Companies should limit pensions, benefits, severance and change of control entitlements
- **PRINCIPLE 6** Effective succession planning reduces paying for retention.[5]

CCGG's Best Practices in Disclosure

CCGG released its 2009 edition of Best Practices in Disclosure of Executive Compensation Information, formerly titled Best Practices in Compensation Disclosure. It provides guidance on how and what to disclose in public documents. It includes helpful examples of many best practices discovered in its review of the annual proxy circulars of over 150 issuers.[6]

CCGG also released its 2009 edition of Best Practices in Disclosure of Director Related Information, formerly titled Best Practices in Shareholder Communication. It provides guidance on how to improve the disclosure of information related to directors, including examples of best practices.[7]

CCGG's Engagement and Say on Pay Policy

In 2009, CCGG published a draft model policy titled "Shareholder Engagement and Say on Pay". The policy is intended to provide guidance to boards on their engagement with shareholders and their approach to executive compensation disclosure. It includes a recommended form of advisory resolution and comments on how to address the results of a say-on-pay vote. As part of this policy, CCGG issued its Board Engagement Policy. The policy outlines how CCGG will engage several Canadian public companies in discussions on compensation practices and board performance, including how companies will be selected, the purpose of the meetings and the process for engagement.[8]

CSA Updates

CSA's Executive Compensation Disclosure Review

In November 2009, the Canadian Securities Administrators (CSA) released the results of its review of the executive compensation disclosure of issuers with years ending on or after December 31, 2008. The goals of the review were to:

- Assess compliance with the disclosure requirements
- Educate issuers about the disclosure requirements
- Identify disclosure requirements that need clarification

Of the 70 companies that were reviewed, 62 generally met the disclosure requirements and were merely asked to improve their disclosure in subsequent years. However, 8 companies did not meet the minimum acceptable disclosure standards and were required to file supplemental executive compensation disclosure in their timely disclosure documents. The most common or fundamental disclosure concerns included failing to:

- Link the discussion on the performance goals in the compensation discussion and analysis to the disclosure in the summary compensation table
- Explain how benchmarking information was used in making decisions about executive compensation
- Quantify incremental payments triggered by a termination or change in control of the company.[9]

Corporate Governance Review Postponed

In November 2009, the CSA announced the postponement of significant changes to Canada's corporate governance regime. In December 2008, the CSA had published for comment proposed changes to the corporate governance regime affecting National Instrument 58-101 *Disclosure of Corporate Governance Practices* and National Instrument 52-110 *Audit Committees* and Companion Policy 52-110CP *Audit Committees*. The CSA received numerous comments about the proposal, including concerns with the timing of the changes. The comments indicated that issuers were currently focused on sustainability issues in the current economic climate and on the transition to the International Financial Reporting Standards. Taking into consideration the comments received, the CSA indicated that the proposed changes would not be implemented. The CSA further indicated that any subsequent proposed changes would not be effective until the 2011 proxy season, at the earliest.[10]

CSA's 2008 Enforcement Report

The CSA released its 2008 Enforcement Report. There were 123 cases completed involving 129 companies and 193 individuals. The following statistics are noteworthy:

- Fines for disclosure violations reached nearly $2 million and costs nearly $500,000
- Fines for insider trading exceeded $1.2 million and costs exceeded $300,000
- 6 individuals were convicted in criminal courts for violating securities laws
- Criminal convictions resulted in jail sentences from 6 months to 8.5 years[11]

CSA's New Online Fee Guide

In July 2009, the CSA introduced a web-based SEDAR Regulatory Fee Guide. SEDAR is the electronic filing system for the disclosure documents of public companies and mutual funds. Its new web-based tool enables users to input basic filing information and obtain a report of the regulatory filing fees for the securities commissions across Canada.[12]

OSC Update

Governance Disclosure

In December 2009, the Ontario Securities Commission (OSC) announced its intention to review compliance with National Instrument 58-101 *Disclosure of Corporate Governance Practices*. The OSC will assess the adequacy of the annual disclosure of corporate governance and environment matters filed by issuers, other than investment funds, in the spring of 2010.[13]

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1 Hugh Mackenzie, "A Soft Landing, Recession and Canada's 100 Highest Paid CEOs" Canadian Centre for Policy Alternatives (January 2010), online: http://www.policyalternatives.ca/sites/default/files/uploads/publications/reports/docs/Soft_Landing_Recession_and_CEOs_0.pdf.

2 Ibid.

3 Corporate Knights, "The Best 50 Corporate Citizens in Canada" (Volume 8.1 Summer 2009, Issue 28) at 16-28 online http://www.corporateknights.ca/special-reports/63-best-50-corporate-citizens.html.

4 FSF Principles for Sounds Compensation Practices (2 April 2009) online: http://www.financialstabilityboard.org/publications/r_0904b.pdf; FSB Principles for Sound Compensation Practices, Implementation Standards (25 September 2009), online: http://www.financialstabilityboard.org/publications/r_090925c.pdf.

5 CCGG, 2009 Executive Compensation Principles, online: http://www.ccgg.ca/media/files/guidelines-and-policies/compensation/CCGG-ECP-FINAL-June2.pdf.

6 CCGG, Best Practices in Disclosure of Executive Compensation Information, online: http://www.ccgg.ca/media/files/guidelines-and-policies/bestpractices/Best%20Practices%20in%20Executive%20Compensation%20Related%20Information%202009.pdf.

7 CCGG, Best Practices in Disclosure of Director Related Information, online: http://www.ccgg.ca/media/files/guidelines-and-policies/best-practices/Best%20Practices%202009.pdf.

8 CCGG, Shareholder Engagement and Say on Pay, online: http://www.ccgg.ca/media/files/guidelines-and-policies/engagement-and-say-on-pay/CCGG%20SOPP%20Final.pdf; CCGG, Board Engagement, online: http://www.ccgg.ca/media/files/guidelines-and-policies/engagement-and-say-on-pay/CCGG%20Board% 20Engagment%20Policy%20Public%20July%2023%2C%202009.pdf.

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

10 CSA Staff Notice 58-305 Status Report on the Proposed Changes to the Corporate Governance Regime (2009) 32 O.S.C.B. 9347 (13 November 2009).

11 CSA, 2008 Enforcement Report, online: http://www.securities-administrators/uploadedFiles/General/pdfs/CSA_Enforcement_Report_English_2008.pdf.

12 CSA, SEDAR Regulatory Fee Guide (2 July 2009), online: http://www.securitiesadministrators.ca/fee_guide.aspx?id=800, see Industry Resources, select Fee Guide.

13 OSC Notice 51-717 Corporate Governance and Environmental Disclosure (2009) 32 O.S.C.B. 10459 (18 December, 2009).