

November 2008



New Requirements for Executive Compensation Disclosure

[Geoffrey Cher](#)
[Derek Sigel](#)

Introduction

The Canadian securities administrators (the CSA) has proposed new rules for executive compensation disclosure which, provided all ministerial approvals are obtained, will affect all issuers with financial years ending on or after December 31, 2008.

The new rules provide for a revised Form 51-102F6 – *Executive Compensation* (the Revised Form) as well as certain consequential amendments to National Instrument 51-102 – *Continuous Disclosure Obligations* and reflect similar measures previously adopted by the United States Securities and Exchange Commission in August 2006.

The amendments are intended to improve the quality and transparency of executive compensation disclosure, by providing greater insight into an issuer's overall stewardship and governance and adopt a principles-based approach to executive compensation disclosure requiring issuers to disclose all direct and indirect compensation provided to the Named Executive Officers (NEOs) and directors notwithstanding that such disclosure may not be explicitly required by the Revised Form requirements.

Summary of significant changes to the disclosure requirements

The purpose of this securities law update is to highlight and summarize certain key changes in the disclosure of executive compensation introduced by the Revised Form. Each of the

following section headings are discussed in greater detail below:

1. Amendments to the manner in which compensation is to be calculated and the determination as to which individuals are NEOs.
2. The introduction of a new compensation discussion and analysis section (CD&A).
3. Amendments to the form and scope of the summary compensation table.
4. Consolidation of and amendments to share-based and option-based incentive plan award disclosure.
5. Enhanced pension plan disclosure and revised table.
6. Heightened disclosure requirements in respect of termination and/or change of control provisions in executive employment contracts.
7. A new section requiring enhanced disclosure of director compensation similar to the summary compensation table of NEOs.
8. Additional requirements in respect of the performance graph.
9. TSX Venture Exchange listed issuers.
10. Preparing for the 2009 Proxy Season.

1. Amendments to the manner in which compensation is to be calculated and the determination as to which individuals are determined to NEOs.

The Revised Form requires issuers to calculate the *total* compensation provided to the three most highly compensated executive officers in

addition to the CEO and CFO in order to determine which executives are to be identified in the Revised Form.

Contrary to the current form requirement, the determination as to total compensation paid is broader than just salary and bonus and has been expanded to include any compensation payable, awarded, granted, given, or otherwise provided, directly or indirectly, by the issuer, or a subsidiary of the issuer, subject to certain exclusions, to each NEO and director. Excluded from these calculations are any payments made under the Canada Pension Plan or similar government and group plans which are generally available to all salaried employees of the issuer. Also excluded are any incremental payments and benefits to an NEO that are triggered by, or result from; (i) termination and change of control benefits received during the most recently completed financial year; and (ii) any cash compensation relating to foreign assignments which are specifically intended to offset the impact of a higher cost of living in the foreign location, that are otherwise related to the duties the NEO performs for the issuer.

Issuers are currently required to disclose any compensation received by an NEO through an arrangement between the issuer and an external management company. The Revised Form requires additional disclosure that specifically allocates the amount of compensation received by the external management company in connection with services provided to the issuer where the external management company also provides executive management services to another company.

2. The introduction of a new compensation discussion and analysis (CD&A) section.

The Revised Form requires the issuer to describe the significant principles underlying compensation policies and to explain the decisions and underlying rationale relating to specific compensation programs for NEOs. The CD&A is intended to heighten the disclosure otherwise required by the "Report on Executive

Compensation" which will no longer be required under the Revised Form.

The CD&A requires issuers to provide a narrative description and analysis that provides readers with a sense of how compensation is tied to the NEO's performance. In particular, the CD&A is to describe the following:

- the objectives of any compensation program or strategy;
- what the compensation program is designed to reward;
- each element of compensation, including the process for determining perquisites and personal benefits and the role of executive officers in determining executive compensation;
- why the issuer chooses to pay each element as well as particular performance goals or similar conditions in respect of specific quantitative or qualitative performance-related factors for NEOs;
- how the issuer determines the amount or formula for each element. This is to include a discussion of the policies and decisions about applicable adjustments of awards, earnings, payments, or payables (if any); and
- how each element of compensation and the issuer's decisions about that element fit into the issuer's overall compensation objectives and affect decisions about the other elements.

In addition, the issuer is to disclose: (i) contractual or non-contractual arrangements, plans, process changes or any other matters that cause the amounts disclosed for the most recently completed financial year to be misleading if used as an indicator of expected compensation levels in future periods; (ii) the basis for selecting events that trigger change of control or termination payments; (iii) whether the issuer used any benchmarking in determining compensation or any element of compensation; and (iv) any waiver or change to any specified performance goal or similar condition.

3. Amendments to the form and scope of the summary compensation table.

The Revised Form includes an expanded summary compensation table which has been amended as follows:

- all elements of the summary compensation table are to be assigned a dollar value, the aggregate amount of which is to be indicated in a total compensation column;
- the “bonus” and “all other annual compensation” columns have been removed. Issuers will be required to allocate incentive compensation into one of the “share-based awards”, “incentive option awards” and “non-equity based compensation” columns;
- the value of all share and option-based awards is to be reported at the grant date fair value as determined in accordance with Section 3870 of CICA Handbook (the Handbook). The issuer is also required to explain the methodology used to calculate the grant date fair value of these awards and to account for any differences in the event that this value is different than that prescribed by the Handbook;
- the addition of a “pension value” column indicating compensatory amounts relating to defined benefit or defined contribution plans; and
- the disclosure threshold for the reporting of perquisites received by NEOs has been adjusted to the lower of \$50,000 or 10% of the NEO’s salary (previously \$50,000 or 10% of total salary *plus bonus*).

Issuers will not be required to disclose comparative period disclosure in respect of a financial year ending before December 31, 2008.

4. Consolidation of and amendments to equity and non-equity share-based and option-based incentive plan awards.

The Revised Form has dispensed with the “Option/SAR Grants During the Most Recently Completed Financial Year” table. The “Aggregated Option/SAR Exercises During the Most Recently Completed Financial Year” as well as “The Most Recently Completed Financial Year and Financial Year-End Option/SAR Values” tables have also been revised.

Issuers will be required to report share and option-based awards to NEOs on both an individual award and aggregate basis. Where a share-based award provides for different payouts depending on the achievement of different performance goals or similar conditions, issuers are to calculate this value based on the minimum payout. If the NEO achieved a performance goal that, on vesting, could provide for a payout greater than the minimum payout, issuers are required to calculate this value based on the expected payout.

Issuers must also indicate the value of share and option-based incentive awards as well as any non-equity incentive plan compensation. In the case of option-based awards, issuers are to calculate the dollar value that would have been realized by determining the difference between the market price of the underlying securities at exercise and the exercise or base price of the options under the option-based award on the vesting date. Although the Revised Form does not address the matter of “underwater” options, it is expected that most issuers will simply allocate a “nil” value to such option grants.

Finally, issuers will be required to provide a narrative that addresses, among other things, any formulae or criteria used to determine amounts payable pursuant to incentive plan awards, performance goals or similar conditions, as well as information on estimated future payouts for non-equity incentive plan awards (performance goals or similar conditions and maximum amounts).

5. A revised pension plan table and enhanced disclosure in respect of pension plans.

The Revised Form requires more specific disclosure of any retirement benefits payable to an NEO, including those payable upon termination. These new requirements will replace those currently found in CSA Staff Notice 51-314 – *Retirement Benefits Disclosure* which contains additional guidance on certain pension disclosure. Issuers are to provide enhanced disclosure of defined pension plan

benefits, defined contribution plans and deferred compensation plans, as well as a narrative discussion of the significant terms and conditions of payments and benefits available under the plans.

6. Heightened disclosure requirements in respect of termination or change of control provisions.

For each contract, agreement, plan or arrangement that provides for payments to an NEO in connection with any termination (whether voluntary, involuntary or constructive), resignation, retirement, change in control of the issuer or a change in an NEO's responsibilities, the Revised Form requires issuers to describe and quantify:

- the circumstances that trigger payments or the provision of other benefits, including perquisites and pension plan benefits;
- the estimated incremental payments, payables, and benefits that are triggered by, or result from, each circumstance, including timing, duration and who provides the payments and benefits;
- how the payment and benefit levels are determined under the various circumstances that trigger payments or provision of benefits;
- any significant conditions or obligations that apply to receiving payments or benefits, including, among other things, the term of the agreements, provisions for waiver or breach as well as any non-compete, non-solicitation, non-disparagement or confidentiality agreements; and
- any other significant factors for each written contract, agreement, plan or arrangement.

In contrast to current requirements, the Revised Form no longer employs the \$100,000 benchmark for reporting change of control or termination benefits for an NEO. Moreover, an issuer is required to disclose estimated incremental payments, payables, and benefits, even if it is uncertain what amounts might be paid in given circumstances under the various plans and arrangements, assuming that the triggering event took place on the last business

day of the issuer's most recently completed financial year. Issuers will not be required to disclose perquisites and other personal benefits received upon a change of control or termination if the aggregate of such compensation is less than \$50,000.

7. A new section requiring enhanced disclosure of director compensation similar to the summary compensation table.

The Revised Form requires issuers to provide director compensation disclosure for the most recently completed financial year in a tabular format similar to the summary compensation table and to provide a narrative description of any significant factors. In particular, issuers are required to identify and disclose all standard compensation arrangements such as fees for retainer, committee service, and meeting attendance as well as any compensation arrangements for a director that are different from the standard arrangements. Moreover, the issuer must identify and disclose any matters discussed in the CD&A that do not apply to directors in the same way that they apply to NEOs, such as practices for granting option-based awards.

8. Additional Requirements in respect of the Performance Graph.

The Revised Form maintains the requirement that issuers (other than issuers listed on the TSX Venture Exchange) are to provide a performance graph indicating the issuer's cumulative total shareholder return over the five most recently completed financial years. The Revised Form permits issuers to use any broad equity market index for the purposes of tracking and comparing the issuer's total return unless it is included in the S&P/TSX Composite Total Return Index, in which case the issuer is to use that index. The Revised Form also requires issuers to discuss how the trend shown by the performance graph compares to the trend in the issuer's compensation to NEOs over the same reporting period.

9. TSX Venture Exchange Listed Issuers.

Issuers listed on the TSX Venture Exchange (Venture Issuers), are subject to all executive compensation disclosure requirements under the Revised Form, with the exception of the performance graph. Although the CSA declined to provide a statutory exemption from the new disclosure requirements for Venture Issuers, the CSA indicated that it would be prepared to consider the merits of applications for exemptive relief on a case-by-case basis in response to concerns regarding the costs of compliance with the new disclosure requirements.

10. Preparing for the 2009 Proxy Season.

The new rules require all issuers to provide enhanced disclosure in connection with executive compensation matters. In light of these new requirements, issuers will likely be required to undertake a review of current compensation policies, procedures and practice in preparing for the 2009 proxy season.

In preparation, issuers should consider taking the following actions:

- Consider and determine which executives will qualify as NEOs.
- Review current compensation arrangements to determine whether any changes are required in light of the new disclosure requirements as well as guidance with respect to certain benefits and perquisites.
- Engage the compensation committee early in the review process in order to determine next steps and to prepare and review CD&A disclosure.
- Determine the appropriate value of any equity-based compensation arrangements through the application of the “accounting fair value” methodology.
- Ensure that internal reporting systems are updated as necessary to gather and track the additional data required by the Revised Form.

- Ensure that any such actions are commenced well in advance of the 2009 proxy season. The Revised Form requires that executive compensation disclosure required to be provided in a proxy circular must appear in full in the proxy circular, rather than be incorporated by reference.

This update is intended as a summary only and should not be regarded or relied upon as advice to any specific client or regarding any specific situation.

If you would like further information regarding the issues discussed in this update or if you wish to discuss any aspect of this commentary, please feel free to contact us.

Wildeboer Dellelce LLP

Wildeboer Dellelce Place
365 Bay Street, Suite 800
Toronto, ON M5H 2V1
Phone: (416) 361-3121
Fax: (416) 361-1790

72 Victoria Street South, Suite 401
Kitchener, Ontario N2G 4Y9
Phone: (519) 741-8708
Fax: (519) 741-9576

