mcdowallassociates.com

141 Adelaide St. W., Suite 905
Toronto, ON M5H 3L5 Canada
T 416 644 6584
F 416 361 0931

MCDOWALL RESEARCH

October 2011

Reporting Peer Groups in Management Disclosure Documents

McDowall Associates conducts a comprehensive annual review of executive compensation disclosure practices of the S&P/TSX 60. 58 organizations reported useable information this year. One area we examine in some detail is peer group reporting. While in the past companies typically made general statements on this matter, the leading companies in disclosure are now providing much more detail.

While all companies under review mentioned they used at least one peer group of companies in determining their executive compensation market competitiveness, 53 companies (91%) identified their list of peers by company name. The remaining 9% of issuers only revealed that they assembled a peer group but provided no detail.

Of the 53 organizations naming their peers, 48 companies (83%) provided statistics relative to their comparators and illustrated the information in a table outlining peer dimensions and performance metrics relative to their own company. Metrics such as average peer-group asset size, revenue, number of employees and geographic sweep was reported. This practice is useful in providing shareholders with a level of comfort that the organizations selected are actually similar to theirs.

One finding that is worthy of attention is the use of multiple peer groups by an increasing number of companies. This emerging practice tabulated in the table below identifies 51% of the S&P/TSX 60 as using multiple peer groups in its market comparisons.

Number of Comparators	**1**	**2**	**3**	**6**
Count	26	21	5	1
Percentage	49%	40%	9%	2%

Further investigation into this practice pointed to three main reasons for assembling more than a single peer group:

- As expected, 16 or 60% reporting multiple groups do so because their enterprise is international in its sweep and these companies wish to recognize both Canadian and foreign markets in their compensation comparisons.
- 4 companies (15%) identified a separate group for the purpose of determining the magnitude of RSU/PSU grants. As organizations continue to split the long term incentive component of their compensation package from stock options alone to a combination of stock options and

restricted share units, the allotment of restricted share units as a proportion of the total long term grant remains difficult to determine. These companies use market based information to help validate their valuation decisions.

- The disclosure of 7 companies (26%) suggests that they use multiple groups to obtain a better read of the compensation market in general.

In McDowall Associate's experience with market reviews we have observed that using multiple peer groups provides better and sustained results than limiting research to a single set of companies. We routinely advise our clients to adopt this practice.

Although at first blush selecting a small group of organizations with a similar profile appears desirable, issues often arise when seeking such a narrowly defined group:

1. It is difficult to find a statistically significant sample of like organizations, especially in the Canadian context where it is rare to locate more than a few companies in a particular industry of similar size.
2. Talent for executives is often sourced from other sectors that are not necessarily direct "business" competitors.
3. Given that the group is very small, year over year reports tend to be susceptible to volatility due to mergers or an organization refusing continued participation. A change in the composition of a small group will change year-over-year results considerably.

In real terms, an enterprise's market for talent is not limited to a few competitors. Examining various markets will provide a company with a more thorough appreciation of its real market for executive talent. As a primary source of compensation data, we usually suggest a peer group of similar organizations employing executives with similar duties and managing operations of a similar size. Supplementing this intelligence McDowall provides other views of the market from various sources. Combining these markets provides the most meaningful and stable results.

This approach is cost effective, provides results that can be duplicated due to the large number of participating companies and does not require approaching targeted companies whenever data needs to be refreshed.

It is clear through this analysis of S&P/TSX 60 CD&As that established disclosure practices go beyond simply mentioning that a peer group of companies is used for compensation comparison purposes. Shareholders strive to ensure they understand why their company has chosen to compare itself to the organizations it has selected. As we see more organizations adopting multiple peer groups, it remains incumbent on these companies to provide convincing reasons as to why they believe these groups represent their market for talent.