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2017 CANADIAN BANK CHIEF EXECUTIVE OFFICER COMPENSATION REPORT

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Executive Summary

The compensation of new Chief Executive Officers shows a definite pattern, depending on whether a new CEO is hired externally or promoted from within. If a new CEO is hired externally, the initial compensation package often is as much as or even greater than the outgoing CEO's package in order to be competitive with the "market". However, if a new CEO is promoted from within, the compensation tends to be somewhat lower than before at first, and then rebound over the next several years.

Gallagher McDowall's 2017 Canadian Bank Chief Executive Officer Compensation Report examines how Canada's five major banks transitioned the target compensation of their new CEOs, each of whom was promoted from within, rather than recruited externally.

The CEO transition period started on October 31, 2013, when Rick Waugh retired from the Bank of Nova Scotia, and ended on November 1, 2017, when Darryl White was promoted to CEO at the Bank of Montreal upon Bill Downe's retirement. During this four-year period, the newly promoted CEO's target compensation typically dropped by about 20% in the first year on average, and soon thereafter started reverting to the former CEO's target.

Meanwhile, 2017 was a very good year for the five bank CEOs (with the sole exception of Bill Downe), as their total compensation awards were between 9% to 14% above their target. These awards were not all "money in the bank", however: typically one-third of the awards were payable in cash, while two-thirds were deferred into the future in the form of stock-based compensation whose value is at risk.

However, there is more to CEO compensation than amount of their current year compensation. Our report demonstrates that each of the CEO's have a significant personal financial stake in the ongoing success of the organizations they lead, ranging from a multiple of 28 to 125 times their base salaries as of October 31, 2017 when taking into consideration the value of their equity stake and the value of their accumulated pension benefits. Clearly, they are encouraged to succeed.

2017 Canadian Bank Chief Executive Officer Compensation

This Gallagher McDowall report provides an update on the compensation of the Chief Executive Officers (CEOs) of Canada's five major banks.

In a somewhat unusual situation, all five of the bank CEOs retired and new CEOs were appointed over the past four years, as follows:

	Bank of Montreal (BMO)	Bank of Nova Scotia (BNS)	Canadian Imperial Bank of Commerce (CIBC)	Royal Bank of Canada (RBC)	Toronto-Dominion Bank (TD)
Retired CEO	Bill Downe	Rick Waugh	Gerry McCaughey	Gord Nixon	Ed Clark
New CEO	Darryl White	Brian Porter	Victor Dodig	David McKay	Bharat Masrani
New CEO Promotion Date	November 1, 2017	November 1, 2013	September 15, 2014	August 1, 2014	November 1, 2014

Interestingly, all five of the new CEOs were promoted from within none were external hires.

In this report we:

1. Review the impact these transitions had on the target total direct compensation(1) of the CEOs over the four-year period (Table 1),
2. Show how their 2017 target total direct compensation was apportioned to each compensation component (Table 2),
3. Compare their actual 2017 compensation awards to their 2017 target awards (Table 3),
4. Calculate how much pre-tax compensation the CEOs actually took home in cash during 2017 (Table 4),
5. Illustrate how their stock ownership levels compare to their bank ownership guidelines, (Table 5)
6. Determine how much deferred equity compensation they had at risk at the end of fiscal 2017 (Table 6),
7. Compare their annual pension benefit credits (Table 7),
8. Show how much of a personal financial stake they had at risk in the future of their banks at the end of fiscal 2017 (Table 8), and
9. Note some changes that we identified in reviewing each bank's management proxy circular for 2017.

1. Target Compensation Comparison

Each of the banks establish a target level of total compensation that the CEO can expect to be awarded for achieving the objectives set by the Board at the beginning of each year. Prior to Rick Waugh's retirement from BNS in 2013, the target total direct compensation for the CEO position at the five banks ranged from $9.5 million at CIBC and BMO to $11.25 million at RBC, with a median of $10,700,000.

By the end of FY 2015, the median target compensation had declined by 16% to $9,000,000, where it remained in FY2016, but started to climb back in FY2017, as can be seen in Table 1 on the next page:

[1] " Target Total direct compensation" includes annual base salary, annual incentive awards and the present value of long-term incentives awarded for the year, such as performance stock units, stock options and deferred stock units, as reported to shareholders in the Summary Compensation Table of the management proxy circular. It does not include pension values or miscellaneous compensation items.

Table 1: Target Total Direct Compensation Changes Over 5 Years

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
BMO	Downe $9,500,000	Downe $10,500,000	Downe $10,500,000	Downe $10,500,000	Downe $10,500,000	White $8,500,000
BNS	Waugh $10,7000,000	Porter $8,000,000	Porter $9,000,000	Porter $9,000,000	Porter $9,500,000	Porter Not Disclosed
CIBC	McCaughey $9,500,000	McCaughey $9,500,000	Dodig $7,500,000	Dodig $7,500,000	Dodig $8,000,000	Dodig Not Disclosed
RBC	Nixon $11,250,000	Nixon $11,250,000	McKay $10,000,000	McKay $11,250,000	McKay $11,250,000	McKay $12,000,000
TD	Clark $11,000,000	Clark $11,000,000	Masrani $9,000,000	Masrani $9,000,000	Masrani $10,000,000	Masrani $10,800,000
Median	**$10,700,000**	**$10,500,000**	**$9,000,000**	**$9,000,000**	**$10,000,000**	**N/A**

Table 2 below illustrates how each bank allocated the CEO's 2017 target total direct compensation, into base salary, annual incentive target, stock unit incentive target, and stock option values.

Table 2: Target Total Direct Compensation Allocation

	BMO (Downe)	BNS	CIBC	RBC	TD	Median
Base Salary	US $1,500,000	$1,000,000	$1,000,000	$1,500,000	$1,250,000	**$1,250,000**
Annual Incentive Target	$1,900,000	$1,500,000	$2,100,000	$2,250,000	$1,750,000	**$2,100,000**
Stock Unit Grant Target	$6,200,000	$5,600,000	$3,920,000	$6,000,000	$4,700,000	**$5,600,000**
Stock Option Grant Value	$925,000	$1,400,000	$980,000	$1,500,000	$2,300,000	**$1,400,000**
Target Incentive Compensation	$9,025,000	$8,500,000	$7,000,000	$9,750,000	$8,750,000	**$8,750,000**
Target Total Direct Compensation	$10,500,000	$9,500,000	$8,000,000	$11,250,000	$10,000,000	**$10,000,000**

The relative weightings of the stock option component vary the most from one bank to another, from a low of 10% of total direct compensation at BMO to a high of 23% at TD.

2. Actual 2017 Awarded Total Direct Compensation

Target total compensation is conditional on achieving the performance objectives of the organization. How did the bank CEOs actually do for 2017?

With the sole exception of Bill Downe (who was in his final year at BMO and whose awards were all granted at target), the actual 2017 CEO total compensation awards were well above their target total direct compensation, as shown in Table 3:

Table 3: 2017 Actual CEO Total Compensation

	BMO (Downe)	BNS	CIBC	RBC	TD	Median
Base Salary	$1,950,650 CAD	$1,000,000	$1,000,000	$1,500,000	$1,250,000	**$1,250,000**
Annual Incentive	$1,414,350 *	$2,610,000	$2,381,400	$3,055,000	$1,920,000	**$2,381,400**
Stock Unit Grant	$6,200,000	$5,800,000	$4,445,280	$6,300,000	$5,145,600	**$5,800,000**
Stock Option Grant Value	$850,000	$1,450,000	$1,111,320	$1,575,000	$2,534,400	**$1,450,000**
Total Incentive Compensation	$7,689,350	$9,860,000	$7,938,000	$10,930,000	$9,600,000	**$9,600,000**
Total Incentive Compensation as % of Target Incentives	100%	116%	113%	112%	110%	**112%**
Total Direct Compensation	$10,500,000	$10,860,000	$8,938,000	$12,430,000	$10,850,000	**$10,860,000**
Total Direct Compensation as % of Target	100%	114%	112%	111%	109%	**111%**

* Reduced by BMO's Board from 100% of his target award to offset the impact of the strong US dollar on his base salary when converted into Canadian dollars.

3. Realized Compensation During the Fiscal Year

Less than one quarter of the FY 2017 compensation awards shown in Table 3 above were payable in cash. Most of their compensation was deferred and subject to downside risks, as well as future upside potential, as follows:

- The stock option award grant values shown in Table 3 above are *entirely* hypothetical, having been determined at the time of grant by using option model valuation assumptions. They have no initial in-the-money value. Their actual realizable value will be based solely on the increase, if any, of the stock price from their initial option grant date until the date they are actually exercised by the executive, which can be over a time period of up to 10 years from the original grant date.

- Stock unit grants are notional deferred awards whose values go up or down with the change in a bank's stock price and the value of dividend payments, usually over a three-year period from the original award. In addition, some of their values may increase or decrease when they vest based on predetermined performance factors, such as return on equity results or relative total shareholder returns over the vesting period.

Based on the information provided by each organization in their proxy disclosures, we have estimated in Table 4 the amount of pre-tax compensation the CEOs *actually* realized during 2017 in the form of cash, stock unit payouts and stock option exercises, as follows:

Table 4 : 2017 Stock Option and Unit Payouts

	BMO (Downe)	BNS	CIBC	RBC	TD	Median
Total Cash Compensation	$3,375,000	$3,610,000	$3,381,400	$4,555,000	$3,170,000	**$3,381,400**
Value of Stock Units that Vested in 2017	$4,686,079	$3,640,350	$1,792,721	$4,333,044	$6,066,865	**$4,333,044**
Gains on 2017 Stock Option Exercises	$0	$4,233,145	$754,608	$2,522,082	$187,998	**$754,608**
Total Realized Stock Compensa-tion	$4,686,079	$7,873,495	$2,547,329	$6,855,126	$6,254,863	**$6,254,863**
Total Realized Compensation	$8,061,079	$11,483,495	$5,928,729	$11,410,126	$9,424,863	**$9,424,863**

With the sole exception of Brian Porter at BNS who exercised the most stock options, the actual realized compensation of the CEOs was less than the size of their 2017 compensation awards

4. Equity Stakes

Institutional investors look carefully at the extent to which the CEO's interests are aligned with their interests as long term shareholders. Two commonly used alignment measures are (a) stock ownership guidelines and (b) the value of their unrealized equity compensation that is currently at risk.

Stock Ownership Guidelines

The purpose of stock ownership guidelines is to encourage executives to have a real equity stake in the company, directly and indirectly. Stock ownership guidelines are usually expressed as multiples of salary for ease of administration.

Each organization's CEO's ownership for guideline comparison purposes includes (a) the value of real common shares owned directly or indirectly by the CEO, plus (b) the target value of the CEO's outstanding but unrealized stock units. The in-the-money value of stock options is ***not*** included for this purpose, however.

As can be seen from Table 5, each of the five CEOs has more than doubled the bank's stock ownership guideline., making this measure less useful at the banks than for other organizations:

Table 5 : Stock Ownership Guidelines

	BMO (Downe)	BNS	CIBC	RBC	TD	Median
Guideline	7 x salary	7 x salary	8 x salary	8 x 3 year average salary	10 x salary	**7.5 x salary**
Year End Status	41 x	30 x	16 x	18 x	65 x	**30 x**

Value of Unrealized Equity Compensation

A better way of looking at the degree of shareholder alignment in the case of bank CEOs is to examine the value of the CEO's unrealized equity compensation to see how much downside risk the individual has, should the stock price drop materially in the future before the awards can be exercised. For this purpose, in Table 6 we have examined:

(a) the target value of the CEOs' unrealized stock units, plus
(b) the in-the-money value of their unexercised stock options,

both calculated as of the banks' October 31, 2017 fiscal year ends.

Table 6: Shareholder Alignment and Unrealized Equity Compensation

	BMO (Downe)	BNS	CIBC	RBC	TD	Median
2017 Stock Unit Year End Values	$53.3 million	$20.2 million	$11.4 million	$21.1 million	$36.0 million	**$21.1 million**
2017 Stock Option Year End In-the-money values	$42.3 million	$12.1 million	$2.8 million	$31.9 million	$26.9 million	**$26.9 million**
2017 Total Year End Value	**$95.6 million**	**$32.3 million**	**$14.2 million**	**$53.0 million**	**$62.9 million**	**$53.0 million**
Corresponding 2016 Total Year End Value	$79.0 million	$23.9 million	$8.6 million	$35.9 million	$33.1 million	**$33.1 million**
One Year Change in Value	21%	35%	65%	49%	90%	**49%**
Change in Stock Price over the Year	16%	35%	8%	35%	36%	**35%**

5. Pension Benefits

Due to pressure from Canadian institutional investors, the pension benefits of the organization CEOs are now subject to hard dollar caps on the additional amount of pension they can be credited for each year of service as CEO, as well as absolute caps on the maximum pension they can receive when they ultimately retire. As a result, the CEO pension benefits cannot be enhanced by receiving large annual incentive awards during the period just prior to retirement.

The current range of potential bank CEO annual pension benefits is significantly lower than the previous CEO norm of $2.0 to $2.5 million, as shown in Table 7:

Table 7: Annual Pension Benefits

	BMO (Downe)	BNS	CIBC	RBC	TD	Median
Additional Annual Pension Credits While CEO	Nil	$125,000	$46,000	$111,000	$110,000	**$110,000**
Pension Cap at Retirement	$1,000,000 US at age 60	$1,500,000 at age 63	$1,000,000 at age 61	$1,250,000 at age 60	$1,350,000 at age 63	**$1,250,000 at age 60**

6. Total CEO Stakes at Risk

Adding it all up, how big of a personal financial stake do each of the bank CEOs have in the ongoing success of the organizations that they lead? We find their stakes are very high, as can be seen from Table 8 below in which we combine

(a) the value of the common shares each CEO owns outright,

(b) the value of his unrealized equity compensation from Table 6, plus

(c) the actuarial value of his accrued pension benefits

as of October 31, 2017 and then compare their total 2017 stakes to their base salaries and their 2016 positions.

Table 8: Total CEO Stakes at Risk

	BMO (Downe)	BNS	CIBC	RBC	TD	Median
(a) Common Shares Owned	$24.2 million	$8.8 million	$2.0 million	$3.2 million	$45.5 million	**$8.8 million**
(b) Unrealized Equity Compensation Stake	$95.6 million	$32.3 million	$14.2 million	$53.0 million	$62.9 million	**$53.0 million**
(c) Actuarial Value of Accrued Pension Benefits	$21.4 million	$12.6 million	$6.2 million	$13.2 million	$15.6 million	**$13.2 million**
2017 Total Value at Stake	**$141.2 million**	**$53.7 million**	**$28.2 million**	**$69.4 million**	**$156.0 million**	**$69.4 million**
Multiple of Base Salary	74 x	54 x	28 x	46 x	125 x	**54 x**
2016 Total Value at Stake	$124.9 million	$41.1 million	$15.9 million	$33.2 million	$105.0 million	**$41.1 million**
One Year Change in Value	13%	31%	77%	109%	49%	**49%**

The variations in the CEO stakes from one bank to another reflect a number of factors, such as differences in their total length of service, and differences in their previous executive position levels. The results show that there is much more to be considered when comparing bank CEOs than the size of their current compensation rewards.

Observations

In reviewing the bank proxy circulars, we noted the following:

BMO

BMO is the only bank that allocates a portion of its executive stock awards in deferred stock units which cannot be exercised prior to an executive's termination or retirement.

BMO awarded Darryl White a one-time CEO promotion grant of $250,000 in deferred stock units. In addition, Mr. White has only one year of credited service under the Bank's executive pension arrangements.

BNS

BNS reduced the Return on Equity weighting under its annual incentive plan in order to double the Customer weighting.

CIBC

The Board made a downward 4.7% adjustment to the bank's 2017 performance factor based on the Bank's performance relative to its peer group.

CIBC acquired PrivateBancorp Inc. in the US during 2017, conditional on their CEO, Larry Richman, joining CIBC. In return for Mr. Richman agreeing not to receive a change of control package of US $8.64 million, he received a right to receive US $8.2 million from CIBC in deferred compensation contingent on his continued employment with CIBC, 25% of which is to be payable in cash and 75% in deferred stock units with three-year vesting.

RBC

RBC's Board made a downward adjustment to the Bank's 2017 performance factor to eliminate the favourable impact of a gain from the sale of Moneris' US operations. The amount of the adjustment was not disclosed, however.

TD

TD is including Return on Tangible Common Equity in its 2018 annual performance calculations with a 10% weighting.

TD has also expanded its incentive clawback provisions to include misconduct, in addition to material misrepresentation resulting in a restatement of financial results, or in the event of a material error.

TD changed executive compensation consultants in 2017 from US-based Frederick W. Cook & Co. to an independent Canadian firm, Hugessen Consulting Inc.

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