



Gallagher McDowall Associates
ARTHUR J. GALLAGHER

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EXECUTIVE COMPENSATION

Be Careful When Crossing The Border!

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EXECUTIVE SUMMARY

What impact does the US market have on Canadian executive compensation? A lot, according to our Gallagher McDowall research team.

We examine this question from the following perspectives:

1. The impact of the recent rise in the value of the US dollar on the average compensation of the CEOs of the publicly traded companies in the S&P/TSX 60 Index.
2. What we have learned from the past in dealing with exchange rate fluctuations.
3. The potential cost of hiring US CEOs to run Canadian companies.

Impact of the US Dollar on Canadian CEO Compensation

Companies have various reasons for paying their CEOs in US dollars: in some cases the CEOs were hired from the US some time ago and continue to be paid in US currency; in other cases, the Canadian portion of a company's business is relatively small compared to the US; in still others, the CEO and the majority of the CEO's direct reports work in the US, not in Canada.

As we noted in our September 2015 article¹, 17 of the companies in the S&P/TSX 60 Index pay their CEOs all in US dollars, rather than in Canadian dollars. In addition, the Bank of Montreal and Canadian Pacific pay their CEO salaries in US dollars, while they pay their incentives in Canadian dollars. If we also add John Chen of BlackBerry², we find that 20 companies, or **one third** of the CEOs in the S&P/TSX 60, are paid in whole or in part in US dollars.

Through most of the 2010 to 2013 period, the Canadian dollar traded around par with the US dollar, as can be seen from the Appendix. Since 2013, however, the value of a US dollar has increased by some 30% over the value of the loonie.

How significant is this 30% increase on the average total direct compensation³ of the S&P/TSX 60 CEOs in Canadian dollars? As much as \$1.1 million, as can be seen from Table 1 below.

Table 1:

US/CDN Exchange Rate	2014 Total Direct Compensation
Par (2013)	\$6.9 million
1.16 (end of 2014)	\$7.6 million
1.30 (late 2015)	\$8.0 million

Digging a little deeper, we can compare the average 2014 CEO total direct compensation of the one third of the S&P/TSX 60 companies that pay their CEOs in US dollars in whole or in part (the "US payees") with the other two-thirds of the CEOs who are paid solely in Canadian dollars (the "Canadian payees"). The differential between the two is as much as \$2.4 million, as can be seen from Table 2.

Table 2:

US/CDN Exchange Rate	US Payee Total Direct Compensation in CDN \$	Canadian Payee Total Direct Compensation	US Payee Premium
Par (2013)	\$7.2 million	\$6.8 million	6%
1.16 (end of 2014)	\$8.4 million	\$6.8 million	24%
1.30 (late 2015)	\$9.2 million	\$6.8 million	35%

¹ <http://www.mcdowallassociates.com/wp-content/uploads/Does-Size-Matter-2015-Update-September-24-2015.pdf>

² We excluded Mr. Chen from our earlier articles due to the impact that his very large on-hire equity compensation award would have had on the year over year comparisons.

³ "Total direct compensation" includes annual base salary, annual incentive awards and the present value of long-term incentives awarded in the year, such as restricted stock units, performance stock units and stock options, as reported to shareholders in the Summary Compensation Table of the management proxy circular.

What We Learned from the Past

Our Gallagher McDowall executive compensation consultants are industry veterans. They have been through a number of periods when Canadian companies have responded to exchange rate volatility by paying executives in US dollars, and later regretting their decisions when the loonie subsequently bounces back.

It is probably unreasonable at this time to assume that the loonie will return to par with the US dollar in the very near future, nor to assume that it will always stay at the current low level. In the present circumstances, for executive compensation planning purposes it may be appropriate to assume the long term average shown in the Appendix of around 80 cents.

Cost to Canadian Firms of Hiring a US CEO

Joining the A. J. Gallagher group of companies earlier this year has given our consultants the opportunity to compare our Canadian compensation database with our extensive US compensation database. To be consistent with the way in which our US database is compiled, we grouped our Canadian sample into 71 companies with revenues under \$5 billion and 53 companies with revenues from \$5 billion to \$50 billion.

Suppose the boards of all the Canadian companies decide to fire their CEOs and to replace them entirely with US CEOs! What would that cost if the Canadian dollar is trading at 75 cents US?

As shown in Table 3, the answer is \$2.7 million higher total direct compensation cost for the first group and \$8.1 million more for the second group.

Table 3:

Annual Revenues in Nominal Dollars	Cost per Canadian CEO	Cost per US CEO in US \$	Cost per US CEO in CDN \$	Additional Cost per CEO
Under \$5 billion	\$4.0 million CDN	\$5.1 million US	\$6.7 million CDN	+\$2.7 million CDN (+71%)
\$5 billion to \$50 billion	\$7.9 million CDN	\$12.0 million US	\$16.0 million CDN	+\$8.1 million CDN (+102%)

The additional total direct compensation cost for all 124 Canadian companies would be a staggering \$621 million CDN! And, these figures do not include the additional costs typically required to entice a US CEO to join a Canadian company, e.g. hiring bonuses, make-whole awards, relocation costs, legal advice, tax advice, etc.

Why are US CEOs so much more expensive than Canadian CEOs?

There are a number of reasons:

1. US CEOs typically have more “clout” with their Boards: a US CEO typically is also the Board Chair, but not in Canada where the Board Chair is usually an independent director.
2. In our experience, the US tends to be more entrepreneurial and less risk adverse, especially at the top executive and board level. This in turn is reflected in a much greater emphasis on equity compensation for the CEO in the US than in Canada, as can be seen in Table 4 below.
3. The Canadian investment community has developed a very strong risk-focused approach to corporate governance advocacy, led by organizations such as the Canadian Coalition of Good Governance, NEI Investments and MEDAC. These groups have influenced boards of Canadian companies on both the design and magnitude of executive compensation.

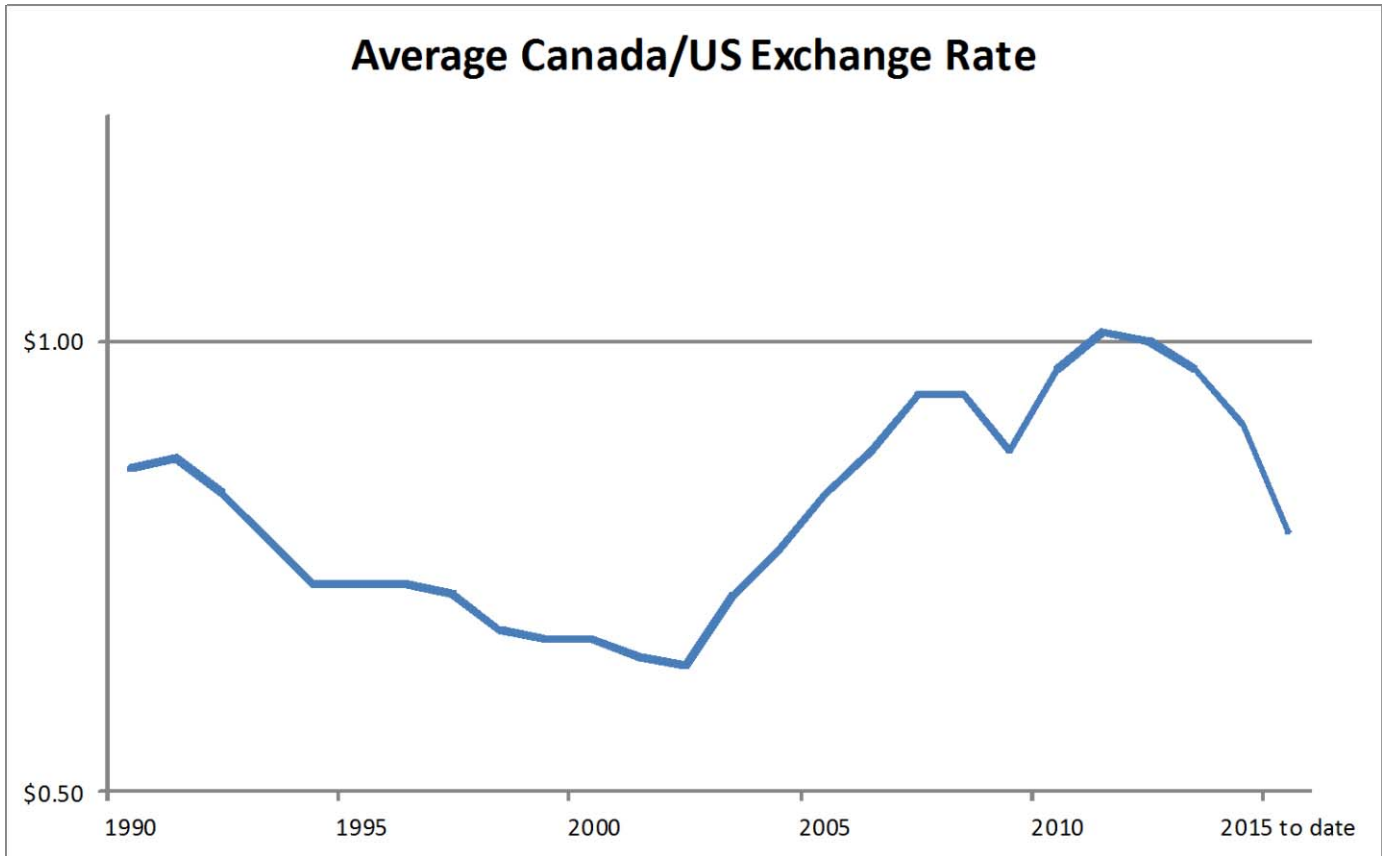
Table 4:

Annual Revenues in Nominal Dollars	Canadian CEO Equity Award	US CEO Equity Award	US CEO Equity Award in CDN \$	Additional Cost per CEO
Under \$5 billion	\$2.2 million CDN	\$3.3 million US	\$4.3 million CDN	+\$2.1 million CDN (+99%)
\$5 billion to \$50 billion	\$4.5 million CDN	\$7.8 million US	\$10.0 million CDN	+\$5.5 million CDN (+125%)

Implications for Canadian Compensation Committees

- Be cautious when including US comparators in your peer group, as they will likely increase the cost of your executive compensation program to a significant degree
- Ask for competitive compensation comparisons to be calculated in nominal dollars where possible, as well as in Canadian dollars
- When negotiating with a US executive, be careful dealing with the exchange rate issue
- As always, make your decisions on the basis of what is in the best long term interests of the organization
- Carefully consider how your decisions will be communicated to your key stakeholders.

Appendix:



For further information, please contact the following Gallagher McDowall executive compensation consultants:

Robert Levasseur
Managing Director
 Email: bob_levasseur@ajg.com
 Telephone: (416) 357-0536

Bernie Martenson
Senior Consultant
 Email: bernie_martenson@ajg.com
 Telephone: (647) 534-7261

Domenico D'Alessandro
Senior Consultant
 Email: domenico_dalessandro@ajg.com
 Telephone: (647) 531-3268

Ray Murrill
Senior Consultant
 Email: ray_murrill@ajg.com
 Telephone: (416) 318-0394

ABOUT GALLAGHER MCDOWALL

mcdowallassociates.com

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

Fully Independent Experts

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Providing market intelligence based on research is foundational to the consideration of alternative strategies.

Subject Matter Experts

Experience matters. Our associates have in-depth knowledge of executive compensation and related areas of practice including Expert Witness Consulting.