

Executive Compensation Bulletin

In this update, we discuss recent developments in the executive compensation arena that will be of interest to our clients.

CANADIAN COALITION FOR GOOD GOVERNANCE

The Canadian Coalition for Good Governance [CCGG] has released its 2013 Annual Report. While their main emphasis currently is on making director elections subject to majority voting by shareholders at all Canadian companies, they continue to push regulators to make annual “say on pay” [SOP] votes mandatory. In addition, the CCGG indicates that they will monitor individual SOP situations “in order to determine whether companies are responding appropriately to the results of these votes”.

The Canadian Coalition for Good Governance 2013 Annual Report is available at:

http://www.ccg.ca/site/ccgg/assets/pdf/2013_annual_report_published_on_june_3,_2014.pdf

The CCGG indicates that it is continuing its program of engaging directly with the board of directors of some 40 to 50 Canadian publicly traded companies each year on governance matters, including executive compensation, risk management, strategy setting and board and management succession.

SEC CLAW BACK TIMETABLE

The Securities and Exchange Commission (SEC) recently indicated that it expects sometime this Fall that the New York Stock Exchange and NASDAQ will release their mandatory compensation clawback proposals, as required by the Dodd-Frank legislation. Once promulgated possibly sometime in

2015 (after formal SEC review and input from what will likely be numerous commentators), the clawback rules will become part of the stock exchange listing requirements.

While, based on past experience, it is unlikely that the clawback requirements will apply to those Canadian inter-listed publicly traded companies deemed by the SEC to be “foreign private issuers”, the final clawback requirements will need to be carefully considered by Canadian boards of directors.

CSA PROXY FIRM GUIDANCE PROPOSALS

On April 24, 2014, the CSA issued a proposed policy intended to provide guidance and recommended practices for proxy advisory firms to consider following a previous July 21, 2012 CSA consultation paper. The CSA proposals are not intended to be prescriptive. The guidance discusses issues such as potential conflicts of interest, transparency and accuracy of vote recommendations, development of proxy voting guidelines and communications with their clients, with issuers, the media and the public.

In our view, the CSA proposals are not likely to have a material impact on the potential for conflicts of interest posed by Institutional Shareholder Services’ consulting business or by Glass Lewis’s ownership by two pension funds.

BRITISH COLUMBIA EXPANDS ITS “COOLING OFF” PERIODS

For the past two years, BC has imposed so called “cooling off periods” on government ministers and deputy ministers, whereby they are required to wait at least one year after resigning before taking on private sector jobs with organizations with which they have had substantial dealings.

On June 11, 2014, the province announced that all of its provincial public sector organizations (including crown corporations, health authorities and post-secondary institutions) will be required to develop strong conflict of interest codes of conduct for all employees and executives. Among other things, these codes will include cooling off periods.

In July 2012, BC introduced its “Crown Corporation Executive Compensation Policy” that capped executive salaries, phased out bonuses, imposed salary holdbacks, eliminated perquisites and made executive compensation disclosure mandatory. While effectively capping executive compensation as intended, they have made executive recruitment and retention challenging in the BC public sector.

ONTARIO BUDGET EXPECTED TO BE REINTRODUCED THIS SUMMER

The May 1, 2014 Ontario Budget could have a significant cost impact on senior managers and executives when it is reintroduced by the re-elected Provincial Government in the Legislature, likely sometime in July.

One of the May proposals was to increase the marginal tax rate on taxable income from \$150,000 to \$220,000 by 1.56% and from \$220,000 to \$514,090 by 3.12%, after taking Ontario’s heavy surtaxes into consideration. These thresholds would not be adjusted for inflation each year. The combined federal and Ontario marginal tax for those with between \$150,000 and \$220,000 of taxable income would be 47.97% and for all those over the \$220,000 threshold would be 49.53%, as compared to 46.41%

in 2013

For individuals with taxable income over the current \$514,090 threshold, the changes would represent an absolute additional 2014 cost of \$10,268 over 2013. We note that these proposals would have increased the CEO tax ratios we illustrated in our December, 2013 and April, 2014 bulletins by about 1.0% for the S&P/TSX 60 companies and 1.1% for the next 60 companies.

ONTARIO’S BILL 179 TO RETURN?

It will be interesting to see whether Bill 179 is reintroduced in the Legislature in order to allow the Ontario Government the ability to “manage executive compensation in the broader public sector by authorizing the establishment of compensation frameworks applicable to designated employers and designated executives” by way of directives and regulation as and when it sees fit.

NEW COMPENSATION DISCLOSURE PROPOSALS FOR VENTURE COMPANIES

On May 22, 2014 the Canadian Securities Administrators [CSA] issued a series of proposals intended to “streamline” the shareholder disclosure requirements for publicly traded companies which are listed on the TSX Venture Exchange. [\[link\]](#)

The compensation components of the Venture disclosure proposals are very similar to those released by the CSA on September 13, 2012. We believe it is reasonable to assume that the Venture compensation disclosure proposals will be implemented largely as in due course, with little if any change because the CSA only asked for comments on is the length of time a Venture company should be given to file its compensation disclosures.

Key differences between the Venture Form 51-102F6V proposals and the standard Form 51-102F6

disclosure requirements that will continue to apply to all companies on the main Toronto Stock Exchange are as follows:

- The Venture Named Executive Officer [NEO] group will only include three individuals: the CEO, the CFO and the next most highly paid executive officer if that person's "total compensation" in the fiscal year exceeds \$150,000 (rather than the three most highly paid officers plus the CEO and CFO)
 - "Total compensation" for purpose of the \$150,000 Venture NEO threshold however will not include All Other Compensation or the Grant Date Fair Value of Equity Awards, but will include any Consulting Fees, Board Retainers, and Commission Income.
 - The practical result of this total compensation threshold is likely that many Venture companies will only have two NEOs (the CEO and the CFO), as their cash compensation tends to be relatively low.
- The Summary Compensation Table [SCT] will only require each NEO's compensation be disclosed for two fiscal years, not for three years.
- The compensation of each member of the Board of Directors must be included in the SCT after that of the NEOs, and not in a separate table. At the same time, each director's compensation must be shown for two years, not just for one year.
- No equity compensation values are to be included in the Venture SCT (i.e. the grant date fair value of share-based awards or option-based awards required by Form 51-102F6 does not have to be reported).
- There is no SCT perquisite disclosure threshold proposed for Venture companies: i.e. the Form 51-102F6 perquisite exclusion of 10% of total compensation or \$50,000 if lesser will not apply.
- The Venture proposals provide specific guidance on the disclosure requirements applicable when external management companies are used by officers or directors of a company, as is often the case with Venture companies.
- A new "Compensation Securities" table will be required showing details of each stock option or other compensation security award outstanding at the year end, followed by footnote disclosure of the "total amount of compensation securities, and underlying securities, held by" each Venture NEO and director at the year end.
- McDowall comment: it is not clear from the proposed wording whether the term "total amount" means the number of shares or the total dollar value, or both.
- A new "Exercise of Compensation Securities by Directors and NEOs" table will provide details on each award that a Venture director or NEO exercised or was paid during the year.
- McDowall comment: this Venture table will provide the kind of exercise information that institutional investors have been requesting be required, but the CSA in its wisdom have to date chosen not to require companies on the main Toronto Stock Exchange to disclose.

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- Details of the material terms of any employment, consulting or management agreements will have to be disclosed for each Venture director, as well as for each NEO, including the incremental payments that would be triggered by or result from a change of control, severance, termination or constructive dismissal.
- While a Venture company would not have to provide a “Compensation Discussion and Analysis” section, it would be required to provide a somewhat similar “Oversight and description of director and named executive officer compensation” discussion that would include performance goals. The section would not require a compensation risk discussion or that the actual names of companies use in a peer group be disclosed, however.
- A Venture company would not be required to include the five year performance graph.

It should be noted that a Venture company can, if it wishes, use the standard Form 51-102F6 disclosure rules.

It will be interesting to see whether the CSA will incorporate some of their Venture proposals and/or clarifications in the next update to the main Form 51-102F6.

CONCLUSION

In our view, to be effective during a time of increasing scrutiny, the design and administration of an executive compensation program need to focus first and foremost on the legitimate interests of the organization and of its executive employees.

TSX Composite Index to see how well they are paid by comparison, and whether their “CEO Tax Ratios” are also significant.

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