

## CORPORATE UPDATE

- Public Companies Update

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## Big Changes Are Here For Executive Compensation Disclosure

*The time is now for public companies to start preparing for the new comprehensive executive compensation disclosure requirements.*

By Geoffrey G. Ritchie

The Canadian Securities Administrators ("CSA") have now implemented major changes to executive compensation disclosure requirements in new Form 51-102F6 under National Instrument 51-102 *Continuous Disclosure Obligations*.

All Canadian reporting issuers – including TSX Venture issuers – will be required to disclose compensation in accordance with these new provisions during any fiscal year ending on or after December 31, 2008.

Disclosure will now be required for all directors and the named executive officers ("NEO's") which include the CEO, CFO and the three most highly compensated officers, other than the CEO or CFO, whose total compensation exceeded \$150,000 for that financial year.

The goal of these new requirements is to improve the quality and clarity of the public disclosure of executive compensation – and more effectively disclose the link between executive pay and performance. The changes require much greater transparency and mark a shift from executive compensation disclosure being a matter of legal compliance to being a key aspect of a company's financial reporting.

Here's an overview of the changes and a summary of what a public company will now be required to provide in terms of executive compensation disclosure.

### New "Total Compensation" Test To Determine NEOs

The determination of who the three executive officers are (other than the CEO and CFO) will now be determined by "total compensation" rather than the executives' total salary and bonus. This may result in different individuals being identified as a company's NEO's than under the previous requirements.

Total compensation consists of all compensation paid, payable, awarded, granted, given or otherwise provided to the NEO directly or indirectly. Companies should be certain to include:

- salary and bonus,
- benefits (excluding those provided to all salaried employees),
- gifts or perquisites,
- the fair value of share-based awards, option-based awards, and non-equity

incentive plan compensation, and

- any other discretionary or non-discretionary compensation provided in the company's summary compensation table (as described below).

Engaging an NEO through an external management company will not change the requirement for total compensation disclosure required for that NEO.

### Extensive Discussion and Analysis Required

Executive compensation disclosure must now include a Compensation Discussion and Analysis ("CD&A") that replaces the former Report on Executive Compensation section required for TSX issuers.

The CD&A requires a discussion and explanation of the significant elements of compensation for each of a company's NEO's, including:

- the objectives of any compensation program or strategy,
- what the compensation program is designed to reward,
- each element of compensation and why the company has chosen to pay each element,
- how the company determines the amount for each element (including a description of the process for the granting and amending of options and other option-based awards), and
- how each element of compensation fits into the overall compensation objectives and how it affects decisions about other elements.

As part of this disclosure, the CD&A must provide comparative benchmarks to explain the relevant components, including the identity of any companies included in the benchmark and the

selection criteria for those companies. This means companies will have to keep detailed documentation of benchmarks and performance targets in order to support their CD&A disclosure.

The CD&A also retains the current requirement for a five-year performance graph, providing an illustration of total shareholder return over a five-year period. However companies must now also discuss how the trend shown in this graph compares to the trend in executive compensation over the same period. Companies exempted from preparing the performance graph include TSX-V issuers, companies that have distributed only debt securities or non-convertible, non-participating preferred securities and certain new reporting issuers.

Companies may limit their disclosure on incentive pay performance targets using a 'reasonableness' threshold where the company has concerns that the release of competitively sensitive information "would seriously prejudice the company's interest". However, when disclosure is withheld, the company must still disclose the percentage of that NEO's compensation for which the performance goals have not been disclosed and discuss the likelihood of the NEO meeting the undisclosed incentive targets.

With such an extensive analysis of compensation practice required, it is wise practice to have a company's Compensation Committee (if applicable) review the disclosure in the CD&A before it is approved by the board of directors and is released to the public. We recommend that a company's Compensation Committee Charter be amended to include this responsibility.

### New Summary Compensation Table to Provide Clarity

To provide a clearer picture of each NEO's compensation, companies are now required to complete a revised summary compensation table for each. All elements of the table must be disclosed in dollar amounts and include a column showing the total dollar value of all compensation paid to each NEO.

Here are the key elements that the table must contain.

**Equity-based compensation.** All equity-based compensation must now be based on the fair dollar value assigned by the board of directors at the time of grant rather than the previous practice of simply stating the number of securities granted. The methodology used to calculate the grant date fair value, the key assumptions and estimates used for each calculation – and the rationale for the company's choice of methodology – must be disclosed in a footnote to the table or a narrative following the table. Companies should note that if the grant date fair value is different from the fair value determined in accordance with Section 3870 of the CICA Handbook (i.e., accounting fair value), they now have a duty to reconcile and explain the difference.

**Non-equity-based compensation.** The non-equity incentive plan column is split into two based on the length of the performance period associated with the awards: (i) Annual - which includes compensation such as bonuses in that financial year and discretionary amounts; and (ii) Long-Term - which includes all compensation that extends beyond that financial year. If the compensation is subject to meeting a future performance goal, the grant date fair value is not reported in the table until the future performance goal or condition has been met and the amount has been earned.

**Pension plan value.** The summary compensation table must now include a column showing all compensation relating to defined benefit or defined contribution pension plans, including service costs and other compensatory items such as plan changes and earnings that differ from the estimated earnings or above-market earnings for defined contribution plans. As previously noted, the calculation of an executive's "total compensation" shall exclude any compensation related to pension plans.

**Comparative period disclosure.** The summary compensation table now requires a comparison to the three most recently completed financial years. Companies are not required to report financial years ended before December 31, 2008, so full year-over-year comparability of the NEO compensation is not required for at least two more financial years.

### Other Compensation Disclosure Required

In addition to the new rules relating to the CD&A and summary compensation table, there are several other disclosure requirements that apply to all issuers.

**Enhanced Termination, Change of Control and Retirement Benefits Disclosure.** Companies must make specific disclosure of potential payments to NEO's upon resignation, retirement, change in responsibilities, termination (voluntary, involuntary or constructive) or a change of control. Companies will be required to describe the circumstances which trigger payments, the mechanism to determine payment and benefit levels and any significant conditions to those payments such as compliance with non-competition, non-solicitation or confidentiality obligations. If the payment amounts are uncertain, the company will be required to quantify them using a reasonable estimate with

disclosure of material assumptions underlying the estimates.

**Expanded Director Compensation Disclosure.** A summary table similar to that required for NEO's must now be included for directors and must include equity disclosure. This disclosure is only required for the most recently completed financial year.

**Incentive Plan Awards.** The new rules require disclosure of incentive plan awards for each NEO. The primary disclosure will be contained in two tables – one for awards that are outstanding and one for awards that are vested. Companies are also required to provide narrative disclosure of the significant terms of all incentive plan awards.

- **Outstanding awards.** For outstanding option-based awards, the company must report the number of securities underlying each unexercised option, the option exercise price, the expiration date and the value of unexercised in-the-money options held at the end of that financial year. In the case of share-based awards, the company must report the number of shares or units that have not vested and the market value of unvested share-based awards.
- **Vested awards.** For vested awards, the company must report the aggregate dollar value of all option-based awards vested during the year, the aggregate dollar value of all share-based awards vested during the year and the amount of all non-equity incentive plan compensation earned during the year.

**Pension Plan Benefits.** Companies will be required to include two tables related to retirement benefits in their executive compensation disclosure: one for defined benefit plans and one for defined contribution plans. The defined benefit plan table will show the number of years of credited service, the annual benefits payable at

year-end and at age 65, the accrued obligation at the start of the year, and the amount of any compensatory and non-compensatory changes in the accrued obligation at year-end for each NEO. The defined contribution plans table will show the accumulated value at the start of the year, the compensatory and non-compensatory amounts, and the accumulated value at the year-end for each NEO. Companies must accompany this with a discussion of any significant factors necessary to understand the information disclosed in the tables.

### Take Time Now To Prepare For Compliance

With the broad changes to disclosure required for 2009, advance preparation will be critical for meeting these new obligations. Here are three steps that companies should take as part of their preparation process:

1. Review the new disclosure rules with the compensation committee and board of directors to ensure they have an understanding of the new requirements.
2. Review existing executive compensation disclosure practices and disclosure systems and consider what modifications need to be made to comply with the disclosure regime.
3. Allow for additional time to prepare executive compensation disclosure to permit thorough review and input from the compensation committee and board of directors as well as external legal and accounting advisors.

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