

# Update

## Corporate Securities Law

December 3, 2008

### Time to Prepare: New Executive Compensation Rules Come Into Force December 31, 2008

The Canadian Securities Administrators have adopted new executive compensation disclosure rules that will come into force on December 31, 2008. These amendments, the first changes to the executive compensation rules since 1994, are intended to provide shareholders with a clearer perspective on executive compensation.

The central elements of the new rules are to require disclosure of:

- all direct and indirect compensation that an issuer's board paid and intended to pay to executives, and
- the *reasons* for the amount of compensation paid to executives so as to provide investors with an understanding of how compensation decisions were made.

The rule changes, which are significant, are similar (though not identical) to the SEC's rules on executive compensation adopted last year. The new rules apply for financial years ending on or after December 31, 2008, so issuers will need to comply with the new rules for the 2009 proxy season.

#### Tips to Prepare for the New Rules

In order to prepare to report under the new rules, there are certain steps that companies should take to ensure they will be fully compliant by the deadline.

1) *Start preparing now.*

The new rules are complex, detailed and will require the collection and development of a significant amount of additional compensation information. The new requirement for compensation discussion and analysis will require extensive involvement of the board of directors, compensation committee, management team and outside advisors. Issuers should begin preparing their executive compensation disclosure as soon as possible.

2) *Examine new executive compensation reports of issuers in the United States.*

Although the new rules implemented by the SEC are not identical to those coming into force in Canada, the policy reasons behind the new rules, and many features, are very similar. Therefore, analyzing the changes made by reporting companies in the United States may help issuers in Canada to get a better sense of how to address the new requirements.

3) *Analyze the policy reasons and general philosophy behind the company's current compensation practices.*

Under the new rules, issuers will be required to disclose detailed reasons for their chosen methods of compensation. Therefore, it will be useful for issuers to establish and articulate a comprehensive policy for executive compensation to consider whether each element of executive compensation is consistent with that policy.

4) *Assemble a change management team and retain expert advice.*

The new rules are intricate. In order to effectively manage the transition, it may be helpful for issuers to form an internal committee or a designated lead person entrusted with the task of ensuring that all of the steps that need to be taken and changes that need to be made under the new rules are satisfied. The committee or

designated lead person may also wish to consult with experienced outside advisors to ensure that the disclosure is fully compliant with the new rules.

## **Overview of Major Changes under the New Rules**

The following is an overview of some of the major changes reflected in the new rules.

### *Compensation Disclosure and Analysis*

The most significant change in the new rules is the inclusion of a Compensation Disclosure and Analysis (“CD&A”) section, which is designed to provide a comprehensive discussion and analysis of the issuer’s compensation philosophy and arrangements.

The CD&A is the responsibility of the issuer (similar to MD&A), unlike the Report on Executive Compensation (which the CD&A replaced) which was a report of the compensation committee.

The CD&A is made up of three parts.

### **Narrative Description**

First, the CD&A must include a narrative description of the types of compensation provided, the method behind and reasons for each element of compensation, and a description of how each element fits into the overall compensation scheme. Specifically, the CD&A must include:

- the objectives of the compensation framework, and what it is designed to reward,
- each element of compensation, including information as to why it was chosen and how the amount of compensation is determined (including new disclosure requirements concerning compensation benchmarks and performance goals), and
- how each element of compensation interacts with other elements, and how it fits within the overall compensation objectives and affects decisions about other elements.

### **Performance Graphs**

Second, similar to the old rules, an issuer must

include in its CD&A a five year performance graph comparing the issuer’s cumulative shareholder return against at least one broad equity market index selected as an appropriate reference point.

### **Option Grants**

Third, there is a specific requirement to disclose the process used to grant option based awards to executive officers and describe the role of executive officers and the compensation committee in setting or amending any equity incentive plan.

### *Summary Compensation Table*

An objective of the new rules is to provide investors with disclosure of all compensation paid to the named executive officers (“NEOs”). The revised summary compensation table includes two new columns, Pension Value and Total Compensation, and is to provide disclosure of the following items:

- salary,
- dollar amounts of share and option grants, based on the grant date fair value,
- dollar amount of non-equity incentive plans,
- value of all pension plans including the compensatory amount for both defined benefit and defined contribution plans, and
- all other compensation, including perquisites, post retirement benefits, gross-ups or other amounts reimbursed, and insurance payments.

Also, while compensation must be broken down into detailed categories, it must also be listed in the aggregate under the Total Compensation column. A narrative must be included to provide context for the amounts awarded as set out in the table. The dollar amount value for equity and non-equity incentive plans is to be calculated based on the grant date fair value of the award. The methodology in determining fair value will need to be described in a footnote to the compensation table and should provide a meaningful and reasonable estimate of fair value of such award.

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## *Pension Plan Benefits*

The new rules significantly increase the scope of required disclosure regarding pension benefits. Two detailed tables must be included, where applicable—one for defined benefit plans and one for defined contribution plans—in each case with a narrative description. The terms of any deferred compensation plan must also be described in detail.

## *Change in Control and Termination Benefits*

Under the new rules, any compensation and benefits (including perquisites and pension benefits of over \$50,000 or that are worth more than 10% of the NEO's total compensation) that may be granted to an NEO upon a change in control of the issuer or in the event that the executive is terminated, resigns or there is a change in responsibilities must be disclosed in detail. The value of the benefits must be stated, calculated as if the triggering event occurred at the end of the year in question, together with a description of the triggers and terms of the termination benefits.

## *Incentive Plan Awards*

The Option/SAR Grants table under the old rules has been replaced with two new tables. Issuers will need to include a table that outlines option-based and share-based awards during the year and an additional table that outlines the value of incentive plan awards that have vested or been earned during the year for option-based awards, share-based awards and non-equity incentive plans. Companies will also have to provide a narrative of the significant terms of all plan-based awards including the number of securities underlying each plan, exercise prices and expiry dates, description of any criteria or formulae used to determine amounts payable, performance goals or similar conditions, vesting of awards, information on estimated future payments for any non-equity plans and the closing market price on a grant date if greater than the exercise or base price.

## *Director Compensation*

Compensation for individual directors must now be reported in substantially the same manner as compensation of NEOs as set out in the Summary

Compensation Table but only in respect of one year as opposed to three for NEOs.

## *Changes for Venture Issuers*

Previously, issuers that reported solely on the TSX Venture Exchange were exempt from certain executive compensation reporting requirements. Under the new rules, the requirements are now substantially the same except Venture Issuers still do not need to provide the cumulative shareholder return performance graph.

## *Canadian Issuers Reporting in the United States*

Given the similarities between the new reporting rules in the United States and in Canada, Canadian companies that are "SEC Issuers" may satisfy the requirements of the new rules if they provide the information required by Item 402 "Executive compensation" of Regulation S-K under the 1934 Act.

Please contact any member of Goodmans corporate securities team should you wish to discuss the new rules.

<b>Gesta Abols</b> gabols@goodmans.ca	416.597.4186
<b>Lawrence Chernin</b> lchernin@goodmans.ca	416.597.5903
<b>John Connon</b> jconnon@goodmans.ca	416.597.5499
<b>Sheldon Freeman</b> sfreeman@goodmans.ca	416.597.6256
<b>Susan Garvie</b> sgarvie@goodmans.ca	416.597.4141
<b>Allan Goodman</b> agoodman@goodmans.ca	416.597.4243
<b>William (Bill) Gorman</b> wgorman@goodmans.ca	416.597.4118
<b>Avi S. Greenspoon</b> agreenspoon@goodmans.ca	416.597.4236
<b>Francesca Guolo</b> fguolo@goodmans.ca	416.597.4238
<b>Stephen Halperin</b> shalperin@goodmans.ca	416.597.4115
<b>Tim Heeney</b> theeney@goodmans.ca	416.597.4195

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<b>Jonathan Lampe</b> jlampe@goodmans.ca	416.597.4128
<b>Dale Lastman</b> dlastman@goodmans.ca	416.597.4129
<b>Victor Liu</b> vliu@goodmans.ca	416.597.5141
<b>Kari MacKay</b> kmackay@goodmans.ca	416.597.6282
<b>David Matlow</b> dmatlow@goodmans.ca	416.597.4147
<b>Neill May</b> nmay@goodmans.ca	416.597.4187
<b>Grant McGlaughlin</b> gmcgloughlin@goodmans.ca	416.597.4199
<b>Shevaun McGrath</b> smgrath@goodmans.ca	416.597.4217
<b>Michael Partridge</b> mpartridge@goodmans.ca	416.597.5498
<b>Stephen Pincus</b> spincus@goodmans.ca	416.597.4104
<b>Meredith Roth</b> meroth@goodmans.ca	416.597.6260
<b>Michelle Roth</b> miroth@goodmans.ca	416.597.6261
<b>Neil Sheehy</b> nsheehy@goodmans.ca	416.597.4229
<b>Mark Spiro</b> mspiro@goodmans.ca	416.597.5140
<b>Bob Vaux</b> rvaux@goodmans.ca	416.597.6265
<b>Kenneth Wiener</b> kwiener@goodmans.ca	416.597.4106