

## Corporate Securities

NOVEMBER 20, 2002

### Executive Compensation Disclosure

Recently, the Canadian Securities Administrators, an umbrella group of the country's thirteen securities regulators, released a report reviewing executive compensation disclosure in Canada. The Report reviewed executive compensation disclosure in management information circulars of 76 companies with varying revenues and in a variety of industry sectors from May to September 2002. The review was undertaken because of a concern of the CSA that issuers were still not providing comprehensive disclosure about how executive compensation was determined.

#### Overview

Of the 76 issuers reviewed, the Report found that most issuers were in compliance with the requirements. However, the CSA identified a number of concerns. The vast majority of the issuers reviewed apparently were not providing all of the detailed information required. The Report found issuers discussed compensation in very general terms without explaining specifically how compensation was determined, or how it was related to the company's performance, details required by Canadian securities legislation. The Report also found widespread use of boilerplate language despite the requirement to avoid it. Also of concern to the CSA was the fact that some issuers mentioned that competitive data was reviewed, but failed to provide adequate detail about that data.

The Report found 7% of companies needed to correct summary compensation tables, 5% had to amend information on options and stock appreciation rates, and 5% had to fix pension plan information, provide further details on employment contracts, or revise multi-year stock performance charts. Following the Report, the CSA issued comment letters to virtually all of the reviewed issuers. Of those issuers, 95% agreed to make prospective changes in their executive compensation disclosure to address the concerns raised in the reviews.

#### Highlights and Recommendations of the Report

The Report consists of an item by item review of corporate compliance with executive compensation disclosure. The following is a brief summary of the CSA's comments and recommendations.

- **Scope.** The Report re-emphasized the general requirement for plain, concise and understandable disclosure. Many issuers failed to disclose all of their company's compensation plans. The CSA advises that executive compensation disclosure must include all types of plans unless specifically exempted.
- **Summary Compensation Table.** Many issuers improperly reported salary/bonus information for their "Named Executive Officers". Non-compliance was most frequent where a NEO was employed for only part of the year, or where bonuses were subject to approval. Inadequate disclosure was also frequently cited where signing bonuses and "perquisites and other personal benefits" were given to an NEO.

# THE UPDATE

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- **Options and SARs.** Issuers were reminded to present the required table for aggregated options/SAR exercises even if there were no exercises during the year.
- **Defined Benefit or Actuarial Plans.** Many issuers failed to account for reasonable future increases in compensation when presenting their pension plan disclosure, as required by the regulations. Issuers were reminded that bonuses considered pensionable income must be included as remuneration such that pension amounts are disclosed for the highest remuneration covered by the plan. Issuers must also disclose the estimated credited years of service for each of the NEOs.
- **Termination of Employment, Change in Responsibilities and Employment Contracts.** Several issuers disclosed employment contracts in the aggregate. Employment contracts must be disclosed for each individual NEO. Aggregate descriptions are insufficient unless all of the contracts are the same. Specific details as to the amount of salary or bonus, and terms and conditions of the contract, must also be accurately disclosed in this section. Reference to the summary compensation table is insufficient.
- **Compensation Committee.** Some issuers failed to report required information regarding committee memberships and relationships of the member to the issuer. Although the information may be available elsewhere in the disclosure, issuers must report this information in this section.
- **Report on Executive Compensation.** The majority of the deficiencies in the Report were related to executive compensation disclosure. Most of the disclosure on executive compensation was inadequate. In the worst cases, no reports or very little information was provided. Significant improvement is required by issuers in order to meet the requirements set out in the regulations. The CSA's main areas of concern are:
  - Boilerplate language that inadequately explained the issuer's reason for paying bonuses, granting options, or awarding other compensation.
  - Issuers often did not explain or were vague about the relative emphasis of each of the various components of compensation. The CSA recommends disclosure of this information through the use of percentages to describe "relative emphasis".
  - Many issuers did not disclose if the amount and terms of outstanding options, SARs, restricted shares and restricted share units were taken into account when determining whether and how many new option grants would be made.
  - Issuers frequently failed to explain the specific relationship of corporate performance to executive compensation.
  - Many issuers failed to provide all the required disclosure for the CEO's compensation, such as:
    - factors upon which the CEO's compensation was based and the relative weight assigned to each factor;
    - the criteria for selecting the competitive group and the level in the group in which the CEO's compensation was placed, if compensation was based on competitive rates; and
    - the relationship of the issuer's performance to the CEO's compensation for the most recent fiscal year. Issuers should provide a description of each measure of the issuer's performance on which compensation was based and the weight assigned to each measure.
- Issuers are also reminded to list the names of the members of the compensation committee as required by the regulations.

- **Compensation of Directors.** Issuers must ensure the number of shares, options or SARs granted to directors as compensation are disclosed under this heading. If this information is disclosed in response to another item in the form, the issuer should cross-reference the information.

### The Next Step

As a consequence of the report, the CSA intends to propose amendments to the forms. These amendments will include the recommendations made in the Report, as well as improvements in the clarity and organization of the requirements correctly prescribed in the forms. We will be monitoring and reporting on the status of these reforms.

We invite you to contact any member of our securities team to review your executive compensation disclosure in light of the CSA report.

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