CSA/ACVM Canadian Securities Administrators Autorités canadiennes en valeurs mobilières

Canadian Securities Administrators' Staff Notice 51-331
Report on Staff's Review of Executive Compensation Disclosure

I. INTRODUCTION

On September 18, 2008, the Canadian Securities Administrators (**CSA**) announced the adoption of revised Form 51-102F6 *Statement of Executive Compensation (in respect of financial years ending on or after December 31, 2008)* (the **Form**). The Form became effective across all CSA jurisdictions on December 31, 2008.

The CSA generally monitors new rules in the first year after implementation to ensure they are working as intended. This process often includes conducting targeted compliance reviews.

In Spring of 2009, staff of the British Columbia Securities Commission, the Alberta Securities Commission, the Ontario Securities Commission and the Autorité des marchés financiers (**we**) launched targeted reviews of executive compensation disclosure to assess compliance with the disclosure requirements in the Form. We reviewed a total of 70 reporting issuers. This CSA staff notice (the **Staff Notice**) reports our findings from these reviews.

II. OBJECTIVE AND SCOPE

Our reviews focused on companies' executive compensation disclosure for their financial years ending on or after December 31, 2008. Our main objectives were to:

- assess compliance with the executive compensation disclosure requirements;
- use the results of the reviews to educate companies about the new requirements; and
- identify any requirements that need clarification or further explanation to assist companies in fulfilling their disclosure obligations.

In setting these objectives, we designed our reviews to help us understand if companies are providing investors with improved executive compensation disclosure. Improved disclosure should provide investors insight into executive compensation as a key aspect of the overall stewardship and governance of a company and allow investors to understand how boards of directors make decisions about executive compensation.

III. GENERAL OBSERVATIONS

Sixty-two of the 70 companies we reviewed filed executive compensation disclosure that generally met the requirements of the Form. Nevertheless, we asked most of these companies to improve their disclosure in future filings, specifically, in respect of the significant disclosure issues discussed in this Staff Notice. Eight of the companies we reviewed provided disclosure that did not meet minimum acceptable standards. We instructed these companies to file supplemental executive compensation disclosure in their timely disclosure documents.

A number of companies we reviewed did not explain sufficiently in the Compensation Discussion and Analysis (**CD&A**) how each element of compensation is tied to each named executive officer's (**NEO**) performance. We frequently found that the CD&A did not fully or accurately describe the process of making executive compensation decisions. We were often unable to tie the discussion in the CD&A to the rest of the company's executive compensation disclosure, including the Summary Compensation Table (**SCT**). This was of particular concern with respect to performance goals and similar conditions.

A number of companies did not provide complete disclosure regarding the use of benchmarks and the determination of performance goals.

A significant number of companies subject to the performance graph requirement did not fully discuss how the trend shown in the performance graph compared to the trend in the compensation of executive officers.

Though most companies were generally in compliance with the SCT disclosure requirements, a number of companies did not satisfy specific requirements under Item 3 of the Form.

We also found significant issues in connection with the disclosure of pension plan benefits and the disclosure of termination and change of control benefits.

We have highlighted most of the significant disclosure issues discussed in Part IV, below, because we found them to be the most common. We have highlighted others, even though we found them only in isolated cases, because they relate to a requirement that is fundamental to the objective of executive compensation disclosure.

In addition to the significant disclosure issues, we identified, in our reviews, a number of other issues. We have included a brief discussion of them in Part V, below.

We do not intend this Staff Notice to be an exhaustive summary of all our concerns regarding executive compensation disclosure.

IV. SIGNIFICANT DISCLOSURE ISSUES

The following table summarizes the significant disclosure issues we identified in our reviews. Each of these issues is discussed in the narrative sections following the table. These observations emphasize principles that all companies should consider when preparing their executive compensation disclosure.

Table 1

Area	Significant Disclosure Issue	Number of Companies with a Significant Disclosure Issue
Compensation discussion and analysis	Performance goals or similar conditions	45
	Benchmarking	42
	Performance graph	16
Summary compensation table	Grant date fair value of multi-year awards	3
	Reconciliation of grant date fair value and accounting fair value	15
Pension plan benefits	Annual lifetime benefit payable at the end of the most recently completed financial year	1
Termination and change of control benefits	Quantification	13

A. Performance goals or similar conditions

Subsection 2.1(4) of the Form requires disclosure of performance goals or similar conditions. We found more significant disclosure issues regarding performance goals than for any other disclosure item.

1. Tie to other executive compensation disclosure

A number of companies did not tie the discussion on performance goals in the CD&A to the disclosure in the SCT, and vice versa.

Example 1

A company discloses a grant of a bonus to an NEO but the CD&A does not explain that the company granted the bonus because performance goals were met. Conversely, another company discloses in the CD&A that performance goals were met but the SCT discloses that no bonuses were earned.

These companies should have explicitly linked the discussion about performance goals in the CD&A with their NEOs' compensation as reported in their SCTs. For example, if a company disclosed a performance goal based on an objective measure in its CD&A and the SCT disclosed a bonus was actually earned, the CD&A should also disclose the actual objective measure achieved in explaining why the company paid the bonus.

2. Corporate goals versus individual performance

A number of companies did not fully and accurately describe the relative importance between corporate-level goals and individual performance objectives in making executive compensation decisions.

Example 2

A company provides meaningful disclosure regarding corporate-level performance goals and goes on to state that individual performance was also evaluated based on other performance goals. The company does not clarify the relative importance of the corporate-level performance goals and an NEO's individual performance in determining the NEO's reported compensation.

The company should have provided this clarification in its CD&A.

3. Use of discretion

A number of companies applied discretion to either increase or decrease compensation following the initial setting of objective performance goals but did not fully explain the discretionary process in their CD&A.

Example 3

A company discloses that it established performance goals based on objective measures at the beginning of the financial year but does not quantify those measures in the CD&A. The company believes that the objective measures were only intended to be guidelines and that the payment of bonuses and the criteria for the payment of bonuses remain at the discretion of the board of directors.

The company should have clarified in the CD&A that the objective measures were only intended to be guidelines and explained the importance of board discretion in determining the actual bonus paid to each NEO.

4. Objective measures

A number of companies did not quantify performance goals that were based on objective measures, such as earnings per share, EBITDA, growth in net sales, and operational targets. The requirement to quantify the objective measures applies regardless of whether the objective measures are guidelines or hard targets.

In Example 3, above, the company does not quantify the performance goals that were based on objective measures. Despite the fact that the objective measures were only intended to be guidelines, the company should have quantified them in the CD&A. As discussed above, the clarification that the payment of bonuses ultimately remained at the discretion of the board of directors should also have been included in the CD&A to place the quantification of the objective measures in context.

5. "Seriously prejudice" exemption

Subsection 2.1(4) of the Form provides an exemption from the requirement to disclose specific performance goals on the basis that disclosure would seriously prejudice the interests of the company. Some companies improperly attempted to rely on this exemption.

Example 4

A company discloses that NEO bonuses are based, in part, on the company achieving an EBITDA target in the financial year. However, the company does not quantify the EBITDA target in reliance on the "seriously prejudice" exemption.

Generally, we think that disclosing past performance metrics based on broad corporate-level financial performance measures like earnings per share, revenue growth, and EBITDA, would not seriously prejudice the company's interests. These measures are generally publicly available in other disclosure documents. Thus, the company should have quantified the historical EBITDA target.

Example 5

A company discloses that NEO bonuses are based, in part on the company achieving target growth in square footage of leasing and building opportunities in the financial year. However, the company does not quantify the growth target in reliance on the exemption.

Reliance on the exemption may be appropriate in respect of performance goals based on historical operational targets. In this example, reliance on the exemption would be appropriate if quantification of the growth target would adversely impact a company's competitive position by compromising the company's ability to negotiate competitive lease rates with prospective tenants or affecting its ability to acquire assets at the lowest cost.

For the purpose of these reviews, we asked each company that relied on this exemption to provide us with analysis of the reasons why it believes disclosure of a performance goal would seriously prejudice the company's interests. Companies should be prepared to provide such an analysis to us in the context of a continuous disclosure review whenever they rely on this exemption.

6. Undisclosed performance goals

Companies that did not disclose specific performance goals often neglected to state what percentage of the NEO's total compensation relates to the undisclosed information and how difficult it would be for the NEO, or how likely it would be for the company, to achieve the undisclosed performance goal.

Example 6

A company does not disclose specific performance goals because disclosure would seriously prejudice the company's interests. The company does not disclose that 50% of the NEO's bonus was subject to the undisclosed performance goal. The company only states that achieving the undisclosed performance goal would be "challenging".

The company should have disclosed that 50% of the NEO's bonus was subject to the undisclosed performance goal.

The company should also have provided contextual disclosure regarding the meaning of the term "challenging". Merely disclosing that achieving an undisclosed performance goal would be "challenging" does not help investors understand how decisions about executive compensation are made. To add context, the company could disclose whether the undisclosed performance goal was achieved in the past. Moreover, if the undisclosed performance goal is incrementally more difficult to achieve based on prior year results, then the CD&A could emphasize that these are "stretch" targets and are intended to promote enhanced performance year over year.

B. Benchmarking

Subsection 2.1(3) of the Form requires that the CD&A disclose any benchmark and explain its components. We found a significant number of disclosure issues in this area.

1. Explanation of methodology

A number of companies did not clearly explain their benchmarking methodologies. Though these companies disclosed that they reviewed the compensation practices of a peer group and listed the components of that group, they did not fully explain how they used that information in decisions about executive compensation.

We note that benchmarks may differ among elements of compensation. For example, a company could benchmark against one peer group for base salaries and another peer group for share-based awards. Similarly, benchmarks may differ among different NEOs. For example, a company may use a U.S. peer group to benchmark for U.S. based executives and a Canadian peer group to benchmark for Canadian executives.

If a company uses different peer groups for different components of compensation or for different NEOs, the company should clearly describe which peer group it used for each component or NEO. The company should also disclose how the benchmark is used.

2. Benchmark group

A number of companies did not fully comply with the requirement to disclose the components of a benchmark group.

Example 7

A company discloses that it based compensation in part on the "market practices of companies in similar industries", and "companies of similar size and revenues" but does not identify the peer companies.

The company should disclose the composition of the benchmark group. A complete list of the benchmark group will provide meaningful disclosure to investors, even if the list is extensive.

The use of compensation data collected from a peer group of companies as a guideline (and not to set hard targets) for compensation constitutes benchmarking and companies should disclose the peer group components. Clarification in the CD&A that the compensation data is only used as a guidepost may be appropriate.

C. Performance graph

Paragraph 2.2(b) of the Form requires certain companies to provide a line graph showing the company's cumulative total shareholder return over the five most recently completed financial years. Companies are also required to discuss how the trend shown by this graph compares to the trend in the company's compensation to executive officers over the same period.

A number of companies did not fully satisfy this comparison requirement.

Example 8

A company merely states that there is no specific relationship between executive compensation and the cumulative total shareholder return over the time period in the performance graph without any further disclosure.

The company should have specifically described the trend in executive compensation and described how that trend compared to the trend in cumulative total shareholder return before indicating that the two trends were not related.

We also found that some companies only compared the trends shown by the performance graph for the three most recently completed financial years (i.e. as if to conform with the SCT disclosure). Despite the three-year disclosure period in the SCT, the performance graph requirement is for a five-year period and the comparison must be over that longer period.

While not a requirement, we found that some companies provided an additional line in the performance graph showing the trend of the NEOs total compensation over the same period. We found this to be an effective and meaningful way of comparing compensation trends with total shareholder performance, when combined with a narrative discussion.

D. Summary Compensation Table

1. Grant date fair value of multi-year awards

Subsections 3.1(3) and (4) of the Form requires companies to disclose the grant date fair value of share-based awards and option-based awards in the appropriate columns in the SCT.

Under these requirements, the grant date fair value of these types of awards must be reported in the SCT in the year of grant irrespective of whether part or all of the award relates to multiple financial years and payout is subject to performance goals and similar conditions, including vesting, to be applied in future financial years.

If payout of an award granted in a financial year is subject to conditions being satisfied in future financial years, the grant date fair value methodology used will typically take these conditions into account. As a result, companies cannot defer reporting a value in the SCT for an award until the conditions have been satisfied in the future or on the basis that the board of directors intended to pay part of that award in a future financial period. The financial year in which the value of an equity incentive plan award is reported in the SCT is determined by the grant date of the award. Likewise, the disclosure of the grant date fair value of share-based and option-based awards in a separate table does not comply with the requirements of section 3.1 of the Form.

Example 9

In 2008, a company grants restricted share units (RSUs) to an NEO. Under the terms of the award, the NEO will be entitled to payout of 1,000 RSUs in each of 2008, 2009, and 2010 if certain performance goals, including vesting, are satisfied in those years. The performance goals, including vesting, in respect of the 2008 part of the award have been satisfied and the company reports the grant date fair value of that part of the award in the 2008 SCT but decides to defer reporting the part of the award related to 2009 and 2010 to the SCT for those years.

The company should have reported the grant date fair value of the entire award, including the parts related to 2009 and 2010, in the 2008 SCT. The grant date fair value methodology used should have taken into account the fact that the NEO will not receive those RSUs unless the performance goals, including vesting, for 2009 and 2010 are satisfied.

2. Reconciliation to "accounting fair value"

Subsection 3.1(5) of the Form requires companies to reconcile any difference between the grant date fair value reported in the SCT and the accounting fair value of share-based and option-based awards. Under this requirement, companies must both state and explain the difference and include a description of the methodology used to calculate the grant date fair value, a description of the key assumptions and estimates used for each calculation, and an explanation of why the company chose that methodology.

A few companies did not satisfy this requirement.

Example 10

A company reports the grant date fair value of an option-based award by discounting the accounting fair value to reflect the fact that a substantial part of the award is subject to performance goals associated with future financial periods. However, the company does not quantify and explain the difference between the grant date fair value and the accounting fair value (e.g. in a footnote to the SCT).

The company should have quantified the difference and provided a footnote explaining the difference in methodology, including the fact that it applied a discount factor to the accounting fair value to reflect that payout of the award is subject to the satisfaction of future performance goals.

Note that in the example described above, the amount actually received by the NEO in the future period will not be reported in the SCT for that future period.

3. Format

Subsection 1.3(2) of the Form permits companies to add tables, columns, and other information, if necessary to communicate the compensation the board of directors intended the company to pay, make payable, award, grant, give or otherwise provide to each NEO and director for the financial year.

We found some companies relied on this subsection to present the SCT in a format different from that required by subsection 3.1(1) of the Form. Though the companies we reviewed appropriately relied on subsection 1.3(2), our consideration of this issue alerted us to the question of when this subsection would not permit alternative presentation. For example, a company cannot rely on subsection 1.3(2) to deemphasize the total compensation column. Such a revision is not necessary to satisfy the objective of executive compensation disclosure.

Example 11

A company's SCT includes a column at the far right (to the immediate right of the total compensation column). The column is titled "adjusted compensation" and discloses total compensation less a one-time share-based award granted to the NEOs. The column is highlighted and presented more prominently than the total compensation column.

The company also provides narrative disclosure in the CD&A, and footnote disclosure in the SCT, of the one-time award, including an explanation of why the company granted the award.

The company should not have added the column to the SCT. Narrative disclosure in the CD&A, and footnote disclosure in the SCT, of the one-time share-based award provide investors with sufficient information to understand why the one-time award was granted and how it fits into the company's overall executive compensation decisions.

E. Pension plan benefits – annual lifetime benefit payable at the end of the most recently completed financial year

Paragraph 5.1(4)(a) of the Form relating to the defined benefit plan table requires companies to disclose the annual lifetime benefit payable at the end of the most recently completed financial year based on years of credited service and actual pensionable earnings.

For purposes of quantifying the annual lifetime benefit payable at the end of the most recently completed financial year, companies should assume at year end that the NEO is eligible to receive pension benefits.

For example, an NEO has not reached the minimum required age of 55 as prescribed by the pension plan to be eligible to receive pension benefits at year end. In this case, the company should calculate the annual lifetime benefit payable as follows:

$$\text{annual benefits payable at the presumed retirement age used to calculate the accrued obligation at year end} \times \frac{\text{years of credited service at year end}}{\text{years of credited service at the presumed retirement age}}$$

The value disclosed as an annual lifetime benefit payable at the end of the most recently completed financial year should have a value other than nil.

F. Termination and change in control benefits – quantification

Subsection 6.1(1) of the Form requires companies, among other things, to describe, explain and where appropriate, quantify, the estimated incremental payments, payables and benefits that are triggered by a termination, resignation, a change in control of the company or a change in an NEO's responsibilities.

A number of companies described in narrative format the payments and entitlements of the NEOs but did not quantify the estimated incremental payments and benefits.

Example 12

A company discloses that if the CEO was terminated without cause, the CEO would be entitled to a payment equal to three years salary and bonus under an employment contract. However, the company does not quantify this amount.

Though investors might be able to estimate those amounts based on the current year's SCT disclosure of the CEO's salary and bonus, the Form requires the company to quantify those amounts in its disclosure of termination and change of control benefits.

We also found that some companies simply disclosed an aggregate amount for all NEOs. Providing an aggregate amount for all NEOs does not satisfy the quantification requirement.

While the Form does not require tabular disclosure of potential post-employment payments, we found the tabular presentation used by some companies to be an effective and meaningful way of disclosing this information.

V. OTHER ISSUES

A. Definition of "grant date"

Under section 1.2 of the Form, "grant date" means a date determined for financial statement reporting purposes under Section 3870 of the Handbook. The requirements under subsections 3.1(3) and (4) of the Form to disclose the grant date fair value of equity incentive plan awards do not apply to commitments to grant such awards in future periods if the date the commitment is made is not the grant date.

B. Long-term non-equity incentive plan compensation

Subsection 3.1(8) of the Form requires companies to disclose all amounts earned that are related to awards under non-equity incentive plans and all earnings on any such outstanding awards. Under this requirement, companies must disclose long-term non-equity incentive plans in column (f2) of the SCT only in the year earned, which typically would be the year in which the award vests or is paid out.

C. Non-equity incentive plan compensation – Value earned during the year

Subsection 4.2(1) of the Form requires companies to disclose the value for non-equity incentive plan compensation earned during the year. This value should be the same as the value for non-equity incentive plan compensation earned during the year required to be disclosed in column (f) of the SCT.

D. Defined contribution plans

Section 5.2 of the Form requires companies to disclose the information on all pension plans other than defined benefits plans. The requirement includes disclosure of both compensatory amounts and non-compensatory amounts. For example, companies cannot claim that the information on non-compensatory items such as the NEO's contributions is personal in order to avoid disclosing the amounts. For the same reason, companies cannot choose to include the compensatory elements of the plan under column (h) "all other compensation" of the SCT.

E. Director compensation

In accordance with subsection 7.1(3) of the Form, the director compensation table must be completed in the same manner as the SCT. Similarly, section 7.3 of the Form requires companies to provide the same incentive plan awards disclosure for directors as required under Item 4 for NEOs, including the "Outstanding share-based awards and option-based awards" table and the "Incentive plan awards – value vested or earned during the year" table.

To comply with section 7.2 of the Form, companies must describe and explain any significant factors necessary to understand the compensation disclosed in the directors compensation table.

VI. CONCLUSION

While only eight of the 70 companies we reviewed were instructed to file supplemental disclosure to cure deficiencies in their executive compensation disclosure, our overall observation is that there remains room for improvement. In particular, we asked most of the companies we reviewed to make varying levels of prospective improvements to their disclosure, specifically, in respect of the significant disclosure issues discussed in this Staff Notice.

We will continue to review executive compensation disclosure as part of our continuous disclosure review programs, focusing in particular on:

- CD&A disclosure, including the need to tie the disclosure of performance goals to NEO compensation, the disclosure of performance goals generally, and the disclosure of benchmarking;

- SCT disclosure, including the recognition of grant date fair value of multi-year awards, descriptions of any differences between the grant date fair value reported in the SCT and the accounting fair value for equity incentive plan awards, and SCT presentation; and

- termination and change in control benefits disclosure.

We encourage companies to review the Form carefully and to use this Staff Notice to assist them in the preparation of their executive compensation disclosure.

VII. QUESTIONS OR COMMENTS

Questions and comments may be referred to:

Andrew Richardson
Deputy Director, Corporate Finance
British Columbia Securities Commission
(604) 899-6730
(800) 373-6393 (toll free)
arichardson@bcsc.bc.ca

Alison Dempsey
Senior Legal Counsel, Corporate Finance
British Columbia Securities Commission
(604) 899-6638
(800) 373-6393 (toll free)
adempsey@bcsc.bc.ca

Tom Graham
Director, Corporate Finance
Alberta Securities Commission
(403) 297-5355
tom.graham@asc.ca

Sonny Randhawa
Assistant Manager, Corporate Finance
Ontario Securities Commission
(416) 204-4959
srandhawa@osc.gov.on.ca

Michael Tang
Senior Legal Counsel, Corporate Finance
Ontario Securities Commission
(416) 593-2330
mtang@osc.gov.on.ca

Frédéric Duguay
Legal Counsel, Corporate Finance
Ontario Securities Commission
(416) 593-3677
fduguay@osc.gov.on.ca

Lucie J. Roy
Conseillère en réglementation
Service de la réglementation
Autorité des marchés financiers
(514) 395-0337, poste 4464
lucie.roy@lautorite.qc.ca

Pasquale Di Biasio
Analyste, Service de l'information continue
Autorité des marchés financiers
(514) 395-0337, poste 4385
pasquale.dibiasio@lautorite.qc.ca

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