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## CSA Propose Amendments To Executive Compensation Disclosure Requirements

On November 19, 2010, the Canadian Securities Administrators (CSA) published for comment proposed amendments to Form 51-102F6 *Statement of Executive Compensation* designed to improve the disclosure investors receive regarding executive compensation. The proposed changes clarify existing requirements and introduce new substantive requirements to enhance the quality of information disclosed by public companies about key risks, governance and compensation matters.

### HIGHLIGHTS

The proposed changes will require companies to disclose:

- whether the board of directors considered the risks associated with the company's compensation policies and practices;
- whether named executive officers (NEO) or directors are permitted to purchase financial instruments designed to hedge their position in equities granted as compensation or held by them;
- where a board has a compensation committee, the level of expertise that the members of the compensation committee have; and
- information about compensation advisors including expanding current requirements to disclose fees paid to compensation advisors and describing the advisor's mandate and any other work performed for the company.

The proposed changes will also require:

- where applicable, companies to explicitly state they are relying on the "serious prejudice" exemption allowing them to withhold specific performance goals or similar conditions on the basis that disclosure would seriously prejudice their interests and explain why the disclosure of corporate performance goals would harm the company's interests;
- prohibit the addition of columns or other information to the Summary Compensation Table that could present information in a format different than what is required; and
- a disclosure of the methodology used to determine grant date fair value of all equity-based awards, among others.

### WHEN DO COMPANIES HAVE TO COMPLY?

The CSA is accepting comments on the proposed amendments until February 17, 2011. If the proposed

amendments are approved they are expected to be in effect for the 2012 proxy season, requiring companies to comply for financial years ending on or after October 31, 2011.

## BACKGROUND

In developing the proposals, the CSA considered the findings of a 2009 CSA targeted compliance review of executive compensation disclosure by a sample of public companies. The findings of that review were reported in CSA Staff Notice 51-331 Report on Staff's Review of Executive Compensation Disclosure (Staff Notice 51-331). The CSA also considered a number of recent international developments in executive compensation disclosure, including new compensation and corporate governance disclosure requirements adopted by the U.S. Securities and Exchange Commission (SEC) for the 2010 proxy season (the 2010 SEC Amendments) and provisions aimed at greater shareholder and regulatory oversight of executive compensation found in the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the Dodd-Frank Act).

## RISK MANAGEMENT IN RELATION TO COMPENSATION POLICIES AND PRACTICES

The CSA propose (not surprisingly in light of the new disclosure requirements found in the 2010 SEC Amendments) to amend the Compensation Discussion and Analysis (CD&A) requirements to broaden their scope to require companies to disclose whether their board of directors considered the implications of the risks associated with the company's compensation policies and practices. Framed that way, it is a safe bet that boards, whether or not they considered the risks associated with their company's compensation policies and practices, will (or should!) do so in the future.

The "real new disclosure obligation" is found in the requirement for a company whose board has completed such a risk analysis to discuss and analyze its broader compensation policies and overall actual compensation practices applicable to its employees generally, and not just the NEO (*i.e.*, the CEO, the CFO and the next three most highly compensated executive officers), if risks arising out of such policies and practices are reasonably likely to have a material adverse effect on the company. Specifically, a company will be required to disclose (i) the extent and nature of its boards' role in the risk oversight of compensation policies and practices; (ii) any practices used to identify and mitigate compensation policies and practices that could potentially encourage a NEO or individual at a principal business unit or division to take inappropriate or excessive risks; and (iii) the identified risks arising from the compensation policies and practices that are reasonably likely to have a material adverse effect on the company.

By focusing on the disclosure of risks that are "reasonably likely to have a material adverse effect" on a company, the proposed amendments are intended to elicit disclosure about incentives comprised in compensation policies and practices that could lead to excessive or inappropriate risk-taking by employees; one of the many contributing factors cited as a basis for the recent problems in the financial markets. Understanding and disclosure (or perhaps more appropriately, disclosure and understanding) of that risk is now required!

The proposed commentary to the CD&A identifies situations which could lead to inappropriate or excessive risk-taking (and that potentially could trigger discussion). These include compensation policies and practices:

- at a principal business unit of the company or a subsidiary that are structured significantly differently than others within the company;
- for certain executive officers that are structured significantly differently than other executive officers within the company;
- that do not include effective risk management and regulatory compliance as part of the performance metrics used in determining compensation;
- where the compensation expense to executive officers is a significant percentage of the company's revenues;
- that vary significantly from the overall compensation structure of the company;
- where incentive plan awards are awarded upon accomplishment of a task while the risk to the company from that task extends over a significantly longer period of time; and
- that contain performance goals or similar conditions that are heavily weighed to short-term rather than long-term objectives.

There may be other features of a company's compensation policies and practices that have the potential to

incentivize its employees to create risks. However, disclosure under the proposed amendments is only required if the compensation policies and practices create risks that are reasonably likely to have a material adverse effect on the company.

#### DISCLOSURE REGARDING HEDGING BY EXECUTIVE OFFICERS AND DIRECTORS

The amendments proposed by the CSA would broaden the CD&A requirements to oblige a company to disclose whether its NEO or directors are permitted to purchase financial instruments (such as prepaid variable forward contracts, equity swaps, collars, or units of exchange funds) that are designed to hedge or offset a decrease in the market value of equity securities granted as compensation or held, directly or indirectly, by a NEO or a director.

Many companies currently explicitly limit hedging practices through their insider trading policies, which often replicate prohibitions found in constating statutes. Current disclosure rules do not mandate an affirmative disclosure of the existence (or not) of a hedging prohibition. Disclosure is not uniform across companies, and in some cases it is not clear whether a board does or does not allow the practice.

The proposed rule, which seemingly requires a relatively simple disclosure (whether or not hedging is permitted), may in fact foster fundamental debates for boards (and, perhaps, require substantially more disclosure than what might initially be anticipated). For example, it may be that companies permitting hedging by a NEO or a director will be pressed to explain why such practices are allowed and the conditions under which they are appropriate. Some are of the view that hedging appears to defeat the stated purpose of equity components of compensation plans. In light of the possible difficulty in explaining to shareholders why such actions are permitted, it is conceivable that boards may simply wish to restrict hedging by NEO and directors.

#### DISCLOSURE WITH RESPECT TO COMPENSATION GOVERNANCE

To address concerns about perceived conflicts of interest, the CSA also propose to expand the CD&A requirements to include disclosure dealing with “Compensation Governance,” which would include the current disclosure requirements related to compensation advisors found in National Instrument 58-101 *Corporate Governance Disclosure* (NI 58-101) as well as incorporate the other requirements found in NI 58-101 to describe the process by which the board determines compensation for the company’s directors and officers.

The proposed changes would require companies to provide a breakdown of all fees paid to compensation advisors for each service provided and to disclose whether the performance of other services for the company at the request of management by the consultant or advisor, or any of its affiliates, must be pre-approved by the board or compensation committee.

The proposed expanded disclosure requirement is similar to rules introduced by the [2010 SEC Amendments](#) in response to critics who contended that compensation advisors may be influenced in recommending executive compensation packages and policies in situations where the compensation advisor is providing additional services to the company, such as human resource, actuarial or benefit administration services. The amendment proposed by the CSA would be consistent with the disclosure currently required in National Instrument 52 – 110 *Audit Committees* for audit-related, tax and other fees.

Where a company has established a compensation committee, the proposed amendments would require that the company also (i) disclose whether or not one or more of the committee members has any direct experience that is relevant to his or her responsibilities in executive compensation; and (ii) describe the skills and experience that enable the committee to make decisions on the suitability of the company’s compensation policies and practices that are consistent with a reasonable assessment of the company’s risk profile.

Finally, in matters of compensation governance, the proposed amendments make it clear that director independence should be assessed in light of the criteria used to determine director independence at the audit committee level.

#### DISCLOSURE OF PERFORMANCE GOALS OR SIMILAR CONDITIONS

The CD&A requirements call for a company to disclose performance goals or similar conditions that are based on objective, identifiable measures. An exemption from this requirement is available on the basis that disclosure would “seriously prejudice the interests of the company.”

Reviews conducted by CSA have shown that it is difficult to recognize in the CD&A when a company is relying on this exemption. Consequently, the CSA propose to amend the CD&A requirements to require a company to explicitly state that it is relying on the exemption and explain why disclosing the relevant performance goals or similar conditions would seriously prejudice the company's interests.

## OTHER MISCELLANEOUS CHANGES

There are also a number of proposed changes in response to disclosure practices that have evolved since the CD&A requirements became applicable. These include, amongst others:

- a prohibition from altering the summary compensation table by adding columns or information; and
- the requirement to disclose the methodology used to calculate grant date fair value of all equity based awards.

## COMMENT PERIOD

Comments on the proposed amendments to the rules are due by February 17, 2011. Information on submitting comments to the CSA can be found on the website of the individual security administrator.

## NEED ASSISTANCE?

Heenan Blaikie has significant experience in helping companies ensure that their executive compensation programs satisfy operational and disclosure requirements. If you have any questions on the subjects addressed in this Securities E-News or would like assistance in assessing their likely impact on your executive compensation plans and arrangements, please feel free to contact us.

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