



An overview of the CSA’s new rules for compensation disclosure (issued 18 Sept ‘08)

And a step-by-step approach to drafting the compensation disclosure section for your 2009 proxy

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Introduction

On September 18, 2008, the Canadian Securities Administrators (CSA) released its new executive and director compensation disclosure regulations, known more specifically as Form 51-102F6. This new form will come into effect on December 31, 2008, and will apply to all proxies issued on behalf of companies with financial years ending on or after that date.

The CSA began work on new executive and director compensation disclosure rules in 2006, following on the SEC’s substantial revisions to the executive compensation disclosure rules in the U.S. The CSA’s first proposal was made public in March of 2007 and received extensive industry comment. Many of these comments, together with some learnings from the U.S. experience with their new disclosure rules, were incorporated into a revised proposal made public in February of 2008. Public comment was again sought, and the final rules were published on September 18th with a few important but relatively minor changes from the February proposals.

This briefing is intended for directors and senior management as a readable summary of the main changes from the old form, and provides a suggested process for revising a company’s proxy disclosure to reflect the new rules. Professionals will also want to consult memoranda issued by law firms and other consultancies which focus on the details of the

Timeline	
1994	<i>Original rules issued</i>
Mar 2004	<i>Latest version of old form implemented</i>
Mar 2007	<i>1st round proposals issued for comment</i>
Feb 2008	<i>2nd round proposals issued for comment</i>
Sept 2008	<i>Final version of Form 51-102F6 issued</i>
Dec 31, 2008	<i>Final version of Form 51-102F6 implemented</i>

new regulations. For overviews of the 2007 and 2008 proposals, please refer to the Hugessen briefings on these topics (issued in April 2007 and February 2008 respectively, and available on our website: www.hugessen.com).

The major changes

The most important changes are in the following areas:

1. **The introduction of a Compensation Discussion & Analysis (CD&A) section.** Similar in concept to the MD&A section, this is intended to ensure that each issuer describes – in plain English – how its compensation program for named executive officers (NEOs) has been constructed (including the identity of any companies used as pay benchmarks), what the plan’s objectives and philosophy are with regard to incenting certain results, and which specific targets and goals it uses to evaluate corporate performance and to set compensation appropriately. A key aim is to provide clarity about the performance sensitivity of the pay opportunities (i.e. the design of the plan) and to further discuss the actual performance assessments and compensation decisions (i.e. how actual award decisions were made). In order to stress the connection between performance and pay, the rules also require a discussion of how the trend in compensation paid to executive officers relates to the company’s total shareholder return (TSR) over five years (a trend that must be depicted in a performance graph that also shows the returns from a broad equity index over the same period). An issuer may also include other relevant performance measures in its CD&A, if the company believes that such measures are more meaningful than the link with share price.

Comment: For those companies who have already brought their CD&As into close alignment with the February 2008 CSA proposals, revising the CD&A one final time will generally be a matter of fine-tuning. Other issuers, by contrast, may find a major rewrite is required to bring their CD&As to the new standard.

2. **Disclosure of specific performance targets.** The new form requires that specific performance targets will need to be disclosed where it is necessary to understanding the executive compensation decisions for the previous fiscal year, and where such targets are based on “objective, identifiable measures, such as the company’s share price or earnings per share”. Targets, however, do not have to be disclosed if to do so “would seriously prejudice the company’s interests”.

Comment: We expect that this requirement will prompt debate within boards on the potential impacts of revealing information formerly assumed to be confidential, but that most issuers will ultimately disclose previous years’ financial performance goals, as initial indications suggest that “seriously prejudice” will be a difficult test to meet.

3. **An enhanced Summary Compensation Table (SCT) and other supporting tables.** The new form requires issuers to provide a dollar value for every element of the issuer’s compensation program, both from ongoing plans (e.g. equity awards or compensatory changes in pension value) and from termination scenarios (e.g. change of control agreements). The SCT now also includes a “total compensation” column as a means of providing investors with a single number that aggregates the value of salaries, bonuses, equity awards (stock

and/or options – both shown at grant date fair value, not accounting value), non-equity incentive awards, pensions, and perquisites.

In addition to the SCT changes, new tables depict the number and potential payout value of equity-based awards, and the value vested or earned during the year on all equity and non-equity incentive awards. Similarly, the section devoted to termination and change of control benefits is intended to present estimates of potential incremental payments from all compensation programs under different termination scenarios (all based upon a hypothetical triggering event as of the previous year end), including change of control, termination with and without cause, retirement, and resignation.

Comment: Much of this information will be old news for those issuers who have in recent years been working towards a “best practice” standard, but will require more work and consideration for those issuers (the vast majority) who will be disclosing this information for the first time.

4. **Expanded disclosure of director compensation.** The format and details required for directors under the new form is now similar in principle to that required for NEOs, and includes both a summary compensation table covering compensation from fees, equity and non-equity instruments, and pensions, and a narrative discussion explaining all factors necessary to understanding director compensation.

Impacts and actions

Many of Canada’s larger issuers, in pursuit of best practices and in anticipation of regulatory reform, have already begun to provide executive and director compensation disclosure reflecting the 2007 and 2008 proposals, so much of the work of adapting to the new form may already have been done. The proxies of most other issuers, by contrast, have in many cases remained unchanged, and will therefore require major revision to meet the standards of the new form.

Recommended approach

If you have not already started to revise your company’s proxy, we would recommend starting as soon as possible; it will take longer than you think. We also recommend that your company allocate the resources necessary to ensure the revision process is completed in a thorough and timely manner. The following is a typical action plan, which will need to be modified where necessary to suit your company’s particular situation:

1. Review other summaries of the new rules. These are produced by consultants and law firms, among others, and are generally both free and available for download from their websites.
2. Determine if the new form applies to your company. As mentioned previously, this is a matter of when your company’s fiscal year-end falls. If it doesn’t apply to your company this year (e.g. if your year-end falls *before* December 31, 2008), it certainly will the following year, and so if possible you should endeavour to bring this year’s proxy into conformance with as many aspects of the new form as time allows. Voluntary early adoption of the new form is permitted under certain conditions, should your company wish to complete a comprehensive revision.

3. Assemble an internal working group and alert key decision makers in your company:
 - a. The working group would typically include the corporate secretary and staff from both HR and Finance, one of whom will need to lead the effort day-to-day. Additional staff may be included to carry out research, analysis, and drafting activities as required.
 - b. Oversight of the process should be provided by the CEO, the chair of the board, and the chair of the board's compensation committee.
 - c. External experts should be consulted and possibly retained to assist, including the company's outside legal counsel (and any more specialized lawyer they may recommend) and compensation consultants as required.
4. Develop a list of the major changes required to your company's existing proxy, using both this briefing and memoranda issued by other firms as initial guides, but supplementing this with a careful and detailed comparison of your current proxy and the requirements of the new form.
5. Review the SEC filings of similar companies (by industry, by size) in the United States. Many tables will have a similar look to those required by the CSA's new form, and CD&As may serve as useful examples (although Canadian tables will indeed differ in the details, and Canadian CD&As will hopefully be shorter and less legalistic in nature).

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Last year's proxy:

6. As soon as possible, redo your company's most recent proxy to conform to the new form. This will provide an opportunity to reflect on the company's compensation philosophies and processes themselves, and to ensure that they are based on best practices and are clear and understandable to investors. It is also an excellent test run for flushing out issues and clarifying understanding.

This year's proxy:

7. Update (from the rewritten 2007 proxy) all newly-required calculations (i.e. grant date values of stock option grants), and populate all tables (like the SCT) as required.
8. Update your CD&A based on 2008 events and information.
9. Combine the results of steps 7 & 8 to produce a rough working draft.
10. Share a draft with the CEO, the chair of the compensation committee, and with external advisors (if not already involved) for feedback and suggestions.
11. Iterate until a final version has been completed. Executive compensation disclosure is sensitive; lots of people will want to have input.

Conclusion

The CSA set out almost two years ago to enhance Canadian executive and director compensation disclosure rules consistent with (though not identical to) regulatory changes made a few months earlier by the SEC. In our opinion the CSA has done a good

job, and has also simplified and rationalized what in the United States is a complex and often confusing set of rules. For many large issuers and others who have worked hard at enhancing their disclosures and aligning with proposed regulatory changes, some incremental work remains. For others, significant efforts lie ahead. With the 2009 proxy season only five or six months away, now is an excellent time to get started.

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