


Proposed new executive compensation disclosure requirements: What you need to know to prepare for upcoming proxy disclosure

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This article appears on
CANADIAN SECURITIES LAW ONLINE

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On September 18, 2008, the CSA published their final rule regarding the repeal and substitution of the current executive compensation disclosure form, also known as Form 51-102F6 (the Current Form). Under this rule, a revised Form 51-102F6 (the New Form) will be implemented, significantly changing current requirements with respect to disclosure of executive compensation and related matters. The CSA published their initial proposals for the overhaul of executive compensation disclosure on March 29, 2007 (the 2007 Proposal) and the Current Form is a result of the subsequent comment and review process. The 2007 Proposal was based to a significant extent on changes adopted by the U.S. Securities and Exchange Commission (the SEC) in August 2006. Following receipt of substantial comments on the 2007 Proposal, the CSA republished a revised proposal on February 22, 2008, which was further revised and published as a final rule on September 18, 2008. The New Form introduces significant changes to the executive and director compensation disclosure requirements from those set out in the Current Form. As currently stated by the CSA, they expect this disclosure to apply in respect of financial years ending on or after December 31, 2008.

Overview

The New Form has been organized into a number of new sections, as discussed in detail below. While a number of requirements found in the Current Form are carried forward, the New Form contains many new disclosure requirements. The New Form introduces, among other things, a requirement for a narrative discussion in the form of a "compensation discussion and analysis" and a revised format for the summary compensation table, which includes a column that sets out the dollar value of total compensation as a single number. A new disclosure section for compensation paid to directors is also included. Disclosure of compensation paid under incentive plans has also been consolidated into one section, which contains significantly revised requirements for the format of the various tables and explanatory disclosure. This includes the requirement to disclose equity-based compensation based on grant date fair value of the grant or award. Other significant changes include expanded pension disclosure and more detailed disclosure on termination or change of control payments. The instructions contained in the New Form state that the objective of the disclosure is to "communicate the compensation the board of directors intended the company to pay, make payable, award, grant, give or otherwise provide to each named executive officer (NEO) and director for the financial year" and that a company's disclosure under the form must satisfy this objective.

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This newsletter was prepared by
members of the Securities Group at
Stikeman Elliott.

Summary compensation table

The New Form introduces a revised format and additional content for the summary compensation table (the SCT) for the Company's NEOs.

Under the New Form, identifying the three most highly compensated executive officers is not just based on salary and bonus, but on total compensation (excluding pension value and certain incremental payments as well as some other prescribed exclusions). This effectively means that, in order to make this determination, the company will need to calculate the value of total compensation under the last column of the SCT for its highest paid executives, including the value of equity and non-equity incentive plan awards.

Another significant change in the New Form is the overhaul of the SCT. Under the New Form, the SCT requires disclosure of each NEO's salary, share-based awards, option-based awards, non-equity incentive plan compensation (separated between annual and long-term plans), pension value (as discussed below), all other compensation and total compensation for the three most recently completed financial years (recognizing, that a three year history in compliance with the new requirements cannot be presented until 2010). Some of these columns are not only new, but also represent significant changes to what is, or is not, to be included.

For example, the salary column requires the disclosure of the dollar value of cash and non-cash based salary that was earned by an NEO during the relevant financial year. As well, for both share-based awards and option-based awards, the value disclosed must be the grant date fair value. If the grant date fair value is different from the accounting fair value as determined in accordance with section 3870 of the CICA Handbook, footnote disclosure is required disclosing the amount, and an explanation, of the difference. The non-equity incentive plan compensation column requires disclosure of all amounts earned for services performed during the relevant year that are related to awards under non-equity incentive plans and all earnings on any such outstanding awards. This column is to include any discretionary cash awards, earnings, payments, or payables that were not based on pre-determined performance goals as well as performance-based plan awards. This category is divided into two subcategories, (i) annual incentive plans (AIPs) and (ii) long-term incentive plans (LTIPs).

The Pension Value column requires disclosure of all compensation relating to defined benefit or defined contribution plans, including disclosure relating to service costs and other compensatory items.

Under the column entitled "All Other Compensation", disclosure is required of all other compensation that is not reported in any other column in the SCT. This includes, but is not limited to, perks, such as property or other personal benefits that are provided to an NEO and that are not generally available to all employees, as well as amounts relating, to among others, incremental payments relating to termination or change of control benefits that occur before the end of the relevant financial year and the dollar value of insurance premiums paid or payable by, or on behalf of, the company for personal insurance for an NEO (if the estate of the NEO is the beneficiary). The threshold for requiring disclosure of perks is an aggregate amount that is equal to or greater than the lesser of \$50,000 or 10% of an NEO's total salary for the financial year. The commentary to this column also clarifies that, generally, an item will not be a perk if it is necessary for a person to do his or her job, even if it provides some personal benefit. If an item is not necessary for a person to do his or her job and provides some direct or indirect personal benefit, it is a perk, regardless of the reason that it is provided, unless it is also available on a non-discriminatory basis to all employees.

The last column of the SCT is a new column and requires disclosure of the aggregate dollar value of all of the other columns on the SCT for each NEO, representing another change from the current table, which does not require disclosure in dollar amounts for certain categories.

Following the SCT, the company is required to provide a narrative discussion explaining any significant factors necessary to understand information contained in the SCT. These include the significant terms of an NEO's employment agreement or arrangement, any repricing or other significant changes to the terms of any share-based or option-based award programs, and the significant terms of any award reported in the SCT, including a description of the formula or criteria to be applied in determining the amounts payable and the vesting schedule.

Compensation discussion and analysis

The New Form also requires a new narrative form of discussion and analysis of the executive compensation provided to NEOs, referred to as compensation discussion and analysis (CD&A). Under the CD&A, the company is required to provide a description and explanation of all significant elements of compensation awarded to, earned by, paid to, or payable to NEOs during the most recently completed financial year. Specifically, the CD&A is to include a discussion of the following:

- a) the objectives of the compensation program;
- b) what the compensation program is designed to reward;
- c) each element of compensation;

- d) why the issuer chooses to pay each element;
- e) how the issuer determines the amount and formula for each element; and
- f) how each element of compensation and the issuer's decisions about that element fit into the issuer's overall compensation objectives and affect decisions about other elements.

In addition to the disclosure set out above, the CD&A also requires the issuer to include disclosure of the following items, to the extent they are applicable: (i) any new actions, decisions or policies that were made after year-end that could affect an understanding of an NEO's compensation for the most recently completed financial year; (ii) a statement of the benchmark used for compensation purposes and an explanation of its components, including companies included in the benchmark group and the selection criteria; and (iii) any performance goals or similar conditions based on objective, identifiable measures, such as share price or earnings per share, unless a reasonable person would consider that disclosure of the specific quantitative or qualitative factors would be seriously prejudicial to the company's interest. If the company discloses performance goals or similar conditions that are non-GAAP financial measures, it must also explain how the company calculates these goals from its financial statements.

The CD&A also includes a requirement to set out a performance graph showing the company's cumulative total shareholder return over the five most recently completed financial years. A new requirement has been added to discuss, under the graph, how the trend shown by the graph compares to the trend in the company's compensation to executive officers reporting under the form over the same period.

Also under the CD&A, the company is required to describe the process used to grant option-based awards to executive officers, including a description of the role of the compensation committee and executive officers in setting or amending any equity incentive plan under which an option-based award is granted.

Incentive plan awards

Item 4 of the New Form requires disclosure of outstanding share-based and option-based awards in the form of two separate tables. The first table requires disclosure of all outstanding awards at year-end and the second table requires disclosure of the value vested or earned on each option-based, share-based and non-equity-based incentive plan during the most recently completed financial year. These tables are to be followed by a narrative discussion that describes and explains the significant terms of all plan-based awards, including non-equity incentive plan awards, but only in respect of awards that were issued, vested or were exercised during the year, or that were outstanding at year-end.

Deferred compensation plans and defined benefit and defined contribution pension plans

Item 5 requires disclosure in tabular form for all defined benefit plans and defined contribution plans. Following the tabular disclosure, the company is required to include a narrative discussion of any significant factors necessary to understand the information disclosed in the tables. Also required is a description of the significant terms of any deferred compensation plan, including the types of compensation that can be deferred, the significant terms of payouts, withdrawals and other distributions, and measures for calculating interest or other earnings, how and when such measures can be changed and at whose election. These measures must also be quantified where possible.

Termination and change of control benefits

The New Form abandons the \$100,000 benchmark for disclosure of change of control or termination benefits for an NEO, requiring disclosure of all amounts, and more detailed disclosure of the compensatory arrangements with NEOs relating to retirement, resignation, termination and change of control. The New Form requires that for each contract, agreement, plan or arrangement that provides for payments to an NEO at, following, or in connection with any termination, resignation, retirement, a change in control of the company or a change in an NEO's responsibilities, the company is required to describe and explain, and where possible quantify, the following:

- > circumstances that trigger payments or provision of other benefits;
- > the estimated incremental payments that are triggered, including timing, duration and who they are provided by;
- > how the payment and benefit levels are determined;
- > any significant conditions or obligations that apply to receipt of payments, including but not limited to non-compete, non-solicitation, non-disparagement or confidentiality agreements (including the terms of these agreements and any provisions contained therein regarding waiver or breach); and
- > any other significant factors for each written contract, agreement, plan or arrangement.

Director compensation

The New Form also includes a new table that requires disclosure of director compensation, which is similar in form to the SCT for NEOs. This table requires tabular disclosure for each director of the fees earned, share-based awards,

option-based awards, non-equity incentive plan compensation, pension value, all other compensation and total compensation provided for the relevant year. Following the table, the New Form also requires the company to include a narrative discussion of any factors necessary to understand director compensation. Tabular and narrative disclosure relating to share-based, option-based and non-equity incentive plan compensation is also required for directors similar to that required for NEOs under Item 4 of the New Form.

Companies reporting in the United States

The New Form carries forward the existing exemption for SEC issuers who provide information required by Item 402 of Regulation S-K under the *Securities Exchange Act of 1934*. As is the case under the Current Form, this exemption does not apply to a foreign private issuer that satisfies Item 402 by providing information required by Items 6.B and 6.E.2 of Form 20-F under the *Securities Exchange Act of 1934*. This effectively means that issuers that fully comply with SEC requirements will be exempt from complying with the New Form, however, those that rely on exemptions available to foreign private issuers will not.

Mandatory annual disclosure for certain issuers

Together with the revisions to Form 51-102F6, the final proposal also adds a new section under Part 11 of National Instrument 51-102 *Continuous Disclosure Obligations*. This new section requires reporting issuers that do not send an information circular to securityholders that includes executive compensation disclosure as required by Item 8 of Form 51-102F5, or an annual information form that includes information required by Item 18 of Form 51-102F2 (such as debt-only reporting issuers), to provide the disclosure required by the New Form within 140 days of their year-end. Item 8 of Form 51-102F5 (which is the form of information circular) requires executive compensation disclosure to be provided if an information circular is sent in connection with an annual general meeting or a meeting at which a company's directors are to be elected or where the securityholders will be asked to vote on a matter relating to executive compensation. This new requirement effectively means that if an issuer does not have such a meeting in any particular year, and does not file an annual information form, it will have to now comply with these new executive compensation disclosure requirements on an annual basis. These new provisions do not apply to certain foreign issuers, however, that comply with information circular and proxy requirements under National Instrument 71-102 *Continuous Disclosure and Other Exemptions Relating to Foreign Issuers*.

Preparing for compliance

To prepare for compliance, issuers may need to make substantial changes to the manner in which they gather and disclose executive compensation. A few suggestions to prepare for compliance include:

- > tracking each component of compensation of a larger group of executives to determine which are the most highly compensated under the New Form;
- > analysing all equity-based compensation arrangements to determine appropriate valuation methodologies and comparing valuations with accounting fair value under Section 3870 of the CICA Handbook;
- > tracking the information necessary to categorize and calculate the aggregate incremental costs of perks;
- > tracking data necessary to comply with the new pension disclosure requirements;
- > reviewing the New Form with the compensation committee to determine whether changes to executive compensation practices are required in light of the new disclosure requirements and to prepare for CD&A disclosure (in respect of which disclosure made by issuers under U.S. CD&A requirements may be a helpful reference); and
- > preparing executive compensation disclosure sufficiently in advance of the 2009 proxy season.

For further information, please contact your Stikeman Elliott representative or any of the authors listed above.