

Staff Notice 51-304

**Report on Staff’s Review of Executive
Compensation Disclosure**

November 2002

1. Purpose of Notice

The purpose of this Notice is to report the findings of our recent review, conducted from May to September 2002, of issuers’ executive compensation disclosure included in management information circulars, and to provide guidance to issuers in complying with executive compensation disclosure requirements.

2. Executive summary

We reviewed 76 issuers and found most issuers are following the requirements. However, we identified one main area of concern where improvement is needed: compensation committee reports. This weakness was also identified when compensation disclosure was last reviewed in depth in 1995.

A vast majority of the issuers reviewed were not providing all the detailed information required. Issuers tended to discuss compensation in very general terms without explaining specifically how compensation was determined or how it related to the companies’ performance, as mandated by the report requirements. We found widespread use of boilerplate language despite the requirement to avoid it (see Section 4, Item IX below). In addition, when determining executive compensation, some issuers mentioned that competitive data was reviewed but failed to provide the appropriate level of detail required. For example, issuers often did not describe with whom the comparison was made and at what level in the comparative group the issuers placed their Chief Executive Officer (CEO)’s compensation.

As a result of our review, we issued comment letters to 75 issuers or 99% of our total sample of 76 issuers. Of our reviews, 72 issuers or 95% agreed to make prospective changes in their executive compensation disclosure to address the concerns raised in the reviews (see Figure 1). Most of the changes to be made will improve disclosure in the compensation

committee reports (see Figure 2). For the remaining issuers, we accepted their compensation disclosure.

Figure 1 - Summary of outcomes

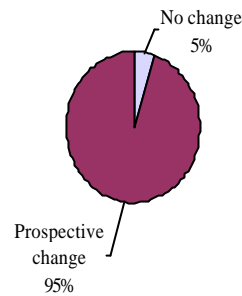
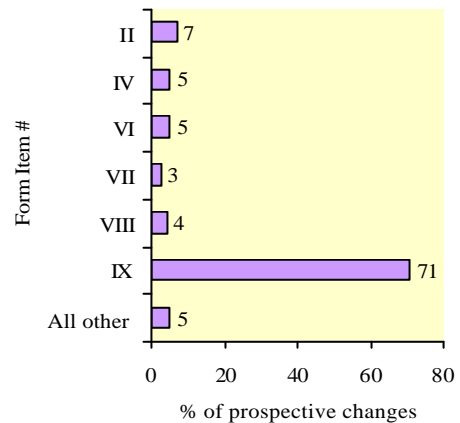


Figure 2 - Outcomes
(% of prospective changes by Forms' item number)



3. Objective and scope of review

Prior to this review, a detailed review on executive compensation disclosure was last conducted in 1995. The 1995 Staff Report on Executive Compensation and Indebtedness Disclosure indicated compensation committee reports needed improvement. We undertook the current review with the concern that issuers were still not providing comprehensive

disclosure about how executive compensation was determined.

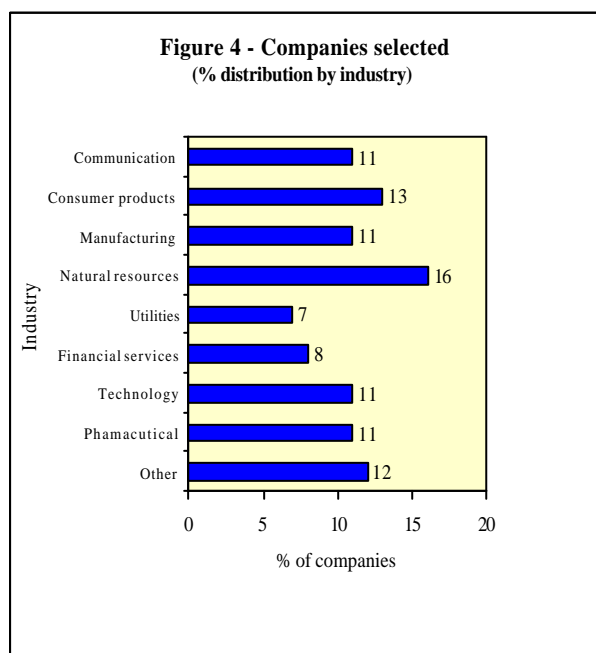
To determine if our concern was warranted, CSA staff carried out a targeted review of a random sample of 76 issuers' executive compensation disclosure included in their management information circulars.

The selected issuers represent a cross section of different sized companies based upon revenues (see Figure 3).

Figure 3
Companies selected (by revenue)

Revenue (\$ millions)	Number	%
Under \$200	31	41
\$200 to \$400	7	9
\$400 to \$2,000	19	25
Over \$2,000	19	25
	76	100

Also, the issuers are from a variety of industries, including financial services, manufacturing and technology (see Figure 4).



The objective of our review was to assess compliance with the securities regulatory disclosure requirements concerning executive compensation contained in the Information Circular. In Ontario, the requirements are contained in Form 40 "Statement of Executive Compensation", found in the regulations to the Ontario Securities Act. In British Columbia, the requirements are contained in Form 51-904F "Statement of Executive Compensation" in the regulations to the British Columbia Securities Act. The other jurisdictions have some similar disclosure requirements.

The following comments provide our interpretation and guidance on the requirements of Forms 40 and 51-904F (the Forms). The item numbers refer to both Forms.

4. Discussion and Staff Guidance

Item I – Interpretation

- a) Definition of plan
 - ? The definition of "plan" in the Forms excludes some plans that are non-discriminatory and are generally available to all salaried employees, but only those plans specifically identified in the Forms such as Canada Pension Plan, group life, health and hospitalization are excluded.
 - ? Unless specifically exempted, all other types of plans are reportable.
- b) Plain, concise and understandable disclosure
 - ? Disclosure of information in tabular form must be presented in the stated format.
 - ? Generally, the table and column names specified in the Forms should be used.
 - ? Changes to table and column names should be minimized and any changes should be clearly described.

Item II – Summary compensation table

- a) Situations where a Named Executive Officer (NEO) is employed only part of the year
 - ? Item I.5 states if an executive was a NEO for part of the year, any compensation disclosures should be reported for the full financial year. In this situation, we have seen two different presentations:
 - (1) partial year salary/bonus reported in the table with a footnote disclosing the salary/bonus that could have been

- earned if the NEO worked for the full year; and
 - (2) full year salary/bonus reported in the table with a footnote disclosing the actual amounts earned.
- ? We prefer the first method because the table emphasizes the actual amounts earned.
- ? If the executive qualifies as a NEO in the most recent fiscal year then the NEO's salary should be reported for the last three years, even if the NEO earned less than \$100,000 in either of the first two years, i.e. the \$100,000 threshold only applies to the most recent fiscal year in determining the NEOs.
- b) Remuneration paid to a NEO for services as a director
 - ? Issuers are reminded that this remuneration should be reported under column (c) "Salary". It is not sufficient to only disclose the remuneration in a footnote to the table.
- c) Bonuses not yet approved
 - ? The Forms require bonuses awarded to, earned by or paid to NEOs to be reported in this table.
 - ? In our view, if an issuer intends to award bonuses, which are still subject to approval, and approval is likely to be granted, these bonuses should be included in this table. A footnote should indicate the bonuses are still subject to approval.
- d) Restricted share definition
 - ? Restricted shares are not defined in the Forms.
 - ? Issuers should refer to the definition of restricted shares in Ontario Securities Commission Rule 56-501 "Restricted Shares".
- e) Signing bonus
 - ? A signing bonus is properly reported in this table under column (i) "All other compensation".
- f) Column (e) "Other annual compensation"
 - ? Only items covered in Item II.4(a) "Perquisites and other personal benefits..." are subject to the \$50,000 and 10% threshold test.
 - ? Items II.4(b) to (g) are not subject to a threshold test and are reported in column (e).

- g) Column (f) "Securities under option/stock appreciation rights (SARs) granted"
 - ? In some instances, the number of options and SARs reported under column (f) of this table for the most recent year did not equal the number reported under column (b) in the "Options and SARs" table required under Item IV.
 - ? The numbers in these two tables should be equal for the most recent fiscal year as one table summarizes the detail contained in the other table.
 - ? Grants of options and SARs in a future year should be excluded from column (f).
 - ? The numbers in the summary table should be reported on an annual basis, not on a cumulative basis.
- h) Column (h) "Long Term Incentive Plan (LTIP) payouts"
 - ? Since option plans are excluded from the definition of LTIP, do not include the value realized from exercising options in this column.
- i) Column (i) "All other compensation"
 - ? We noted that contributions to defined contribution, defined benefit, RRSP and savings plans were sometimes either disclosed in the wrong column (column (e)) or not disclosed at all. These contributions are properly reported under column (i) in this table.
 - ? Perquisites and other personal benefits do not belong in this column but should be reported in column (e).

Item IV – Option and SARs

We remind issuers with outstanding options or SARs to present the table required under Item IV.4 "Aggregated option/SAR exercises during the most recently completed financial year and financial year-end option/SAR values" even if there were no exercises of these securities during the year.

Item VI – Defined benefit or actuarial plan disclosure

Some issuers' pension plan tables did not allow for reasonable future increases in compensation as required by Item VI.3. Issuers should provide for these increases in the table or alternatively show the highest compensation as equal to 120% of the amount of the NEO's covered compensation as required by

Item VI.3. Also, if bonuses are considered in pensionable income then they should be included in remuneration in the table such that pension amounts are disclosed for the highest remuneration covered by the plan.

We remind issuers to disclose the estimated credited years of service for each of the NEOs as required by Item VI.2(b).

Item VII – Termination of employment, change in responsibilities and employment contracts

Employment contracts should be disclosed for each NEO. It is not sufficient to aggregate them unless they are all identical.

Some issuers did not provide the specific details of a contract, such as the amount of the salary or bonus and others did not describe all of the terms and conditions of the contract. These details are required disclosure under this Item. It is not sufficient to refer to the Summary Compensation Table.

Item VIII – Compensation committee

Although our focus was on compliance with the disclosure requirements, the following provides some interesting observations about practice:

- a) Of the issuers selected for review, 72 or 95% had a compensation committee (see Figure 5).
- b) Of those issuers with compensation committees, only 43 or 60% had committees composed entirely of independent members (see Figure 5).
- c) All the compensation committees had at least one independent member.

Figure 5
Compensation committees & independence of members
(Number of companies by revenue)

Revenue (\$millions)	(A) Companies selected		(B) Companies with compensation committees			(C) All independent members on compensation committees		(C)/(B) %
	Number	%	Number	%	(B)/(A) %	Number	%	
Under \$200	31	41	28	39	90	16	37	57
\$200 to \$400	7	9	7	10	100	5	12	71
\$400 to \$2,000	19	25	18	25	95	9	21	50
Over \$2,000	19	25	19	26	100	13	30	68
Total	76	100	72	100	95	43	100	60

We noted a small number of issuers did not report the information required by Item VIII, e.g. committee memberships and relationships of the member to the issuer. Although the information may be available elsewhere in the information circular, issuers should report it in this section.

If a committee member who signs the Item IX “Report on executive compensation” is different from those who are reported as members under this item during the year, then the issuer is encouraged to disclose this as well as any relationships requiring disclosure.

Item IX – Report on executive compensation

We continue to be concerned about the adequacy of disclosure relating to the report on executive compensation. In the worst cases, no reports or very little information were provided. This is an important disclosure requirement that should not be overlooked. As a result of our review, 71% of the changes issuers agreed to make relate to improvements in this area. We believe significant improvement is required by issuers in order to meet the requirements set out in the regulations. The main areas of concern and our comments follow:

- a) Many issuers used boilerplate language instead of adequately explaining their reasons for paying bonuses, granting options or awarding other compensation. This was an area upon which almost all issuers were asked to improve (see Figure 6).

Figure 6 – Item IX Examples

Here are two examples of boilerplate language from different reports that do not give a reader much insight into how the issuers determine compensation. The use of generalities and the absence of specific required compensation information significantly decrease the value of these disclosures:

Example 1

“The Board of Directors is of the view that the Executive Compensation Plan is appropriate for the Company in that it provides an adequate level of motivation for the executive officers”.

This issuer did not provide much detail about its plan, which consisted of salary, bonus and options. For example, it did not disclose why a bonus was paid, the relative emphasis on the various components of compensation, if the amount and terms of existing options were taken into account when determining whether and how many new option grants would be made, and the relationship of corporate performance to executive compensation.

In response to our comments, the issuer stated that some of the content is described elsewhere in the information circular and other requirements were inadvertently overlooked. In this case, the issuer agreed to include all the disclosure required by Item IX under this heading in its future filings.

Example 2

“Base salary levels for all executive officers (including the Executive Chair and CEO) are based upon performance and in relation to comparable positions within the industry and in the markets in which the Corporation operates....”

This statement is too general. For example, it does not explain how performance is determined, the industry and markets being reviewed and the level in the comparative group the CEO’s compensation was placed. Also, there is no discussion of the relative emphasis being placed on salary, bonus and options. Similar to Example 1, the issuer agreed to include all the disclosure required by Item IX in its future filings.

- b) Many issuers did not explain or were vague about the relative emphasis of each of the various components of compensation. This can best be disclosed through use of percentages to describe “relative emphasis”.
- c) 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.
- d) Many issuers did not explain the specific relationship of corporate performance to executive compensation. Issuers are required to explain how corporate performance affected executive compensation. For example, if bonuses are tied to corporate performance, this relationship should be explained. Issuers should also explain what performance level was achieved during the year and the resulting impact on the bonus awarded.
- e) Many issuers did not provide all the required disclosures for the CEO’s compensation, including:
 - ? The factors and criteria upon which the CEO’s compensation was based and the relative weight assigned to each factor. As already mentioned, “relative weight” can best be described by percentages.
 - ? The basis 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.
 - ? 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 their performance on which compensation was based and the weight assigned to each measure.

Also, we remind issuers to list the names of the members of the compensation committee as required by Item IX.4.

We received commitments from all issuers with inadequate disclosure that all future Forms’ filings

will include more meaningful and enhanced disclosure. We will be monitoring these future filings.

Item X – Performance graph

We raised very few comments relating to the performance graph. However, we noted some issuers were using the wrong measurement point when they graphed more than five years of data. In this situation, the measurement point should be a fixed \$100 investment at the beginning of the issuer’s fifth preceding financial year.

Due to the discontinuance of the TSE 300 Stock Index, affected issuers should use the S&P/TSX Composite Index as its replacement in preparing the performance graph. For more information on how this new index is calculated and which companies are included, consult the Toronto Stock Exchange’s website, www.tse.com.

Item XI – Compensation of directors

In our view, the number of shares, options or SARs granted to directors as compensation should be disclosed under this heading. However, if this information is disclosed in response to another item in the Forms, a cross-reference should be made.

Of the issuers reviewed, 56 or 74% grant options to directors in addition to regular cash compensation (see Figure 7).

Figure 7
Granting options to directors
(Number of companies by revenue)

Revenue (\$millions)	(A) Companies selected		(B) Companies granting options		
	Number	%	Number	%	(B)/(A) %
Under \$200	31	41	25	44	81
\$200 to \$400	7	9	2	4	29
\$400 to \$2,000	19	25	13	23	68
Over \$2,000	19	25	16	29	84
	76	100	56	100	74

Item XIV – Issuers reporting in the United States

In Item XIV.2, the references to Items 11 and 12 of Form 20-F have changed to Items 6B and 6E.2, respectively. We noted this for incorporation in future amendments to the Forms.

5. The next step

Based on our review, we are going to propose amendments to the Forms. The amendments will include those discussed in this Notice as well as improvements in the clarity and organization of the requirements discussed in the Forms.

You are encouraged to monitor the status of the proposed National Instrument 51-102 “Continuous Disclosure Obligations” which includes executive compensation disclosure in Form 51-102F6. This proposal intends to harmonize continuous disclosure requirements across Canada.

6. Questions

Please refer your questions to any of the following:

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