[TRANSLATION]

MOUVEMENT D’ÉDUCATION ET DE DÉFENSE DES ACTIONNAIRES

MÉDAC

Montréal, January 25, 2011

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Mr. Mario Albert

Interim President and CEO

Autorité des marchés financiers

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Dear Mr. Albert:

The purpose of this letter is to submit our brief on the *Regulation to amend Regulation 51-102 respecting Continuous Disclosure Obligations* including *Form 51-102F6, Statement of Executive Compensation.*

Given the key role that compensation structures played in the recent financial crisis, we believe that the regulatory authorities must promote in-depth change in how such structures are designed, so that investors can be assured that they no longer encourage excessive risk-taking and, furthermore, tie components of corporate ethics and social responsibility to short-, medium- and long-range results.

In our opinion, the new regulation must go beyond the orientations suggested in the Notice and Request for Comment, and set out clear guidelines on the following points, among others:

- Alignment of executive performance criteria with the organization's long-term objectives, both financial and non-financial
- Equity towards all employees by respecting a pre-established ratio between the compensation paid to the most senior executive and the median compensation paid to employees; the ratio should never be greater than 30 times an employee's median compensation
- Shareholder participation, by means of an annual "say on pay" vote, with respect to executive compensation and compensation paid upon a change in control (golden parachutes)
- The independence of compensation committee members and the committee's compensation experts
- Consideration of risk in evaluating executive performance to ensure sound, efficient management of risks in the corporation and discourage excessive risk-taking
- A balance between fixed and variable compensation
- Variable compensation, including 60% that is deferred over a period of more than three years, with the option to claw back some or all of the amounts allocated in the event of a material correction to the financial statements, excessive risk-taking, or failure to achieve subsequent objectives
- Have all variable compensation subject to the achievement of specific objectives

I would thus ask you to send a strong signal to our executives by asking them to substantially change their approach to setting compensation policies while aiming for greater transparency, a strong incentive to greater moderation.

Sincerely,

Claude Béland

Chair

cc Me Anne-Marie Beaudoin

AMF Secretary

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MÉDAC

BRIEF SUBMITTED FOR CONSULTATION ON THE

Draft *Regulation to amend Regulation 51-102 on Continuous Disclosure Obligations*, including *Form 51-102F6*, *Statement on Executive Compensation*

and consequential amendments

January 25, 2011

## ABOUT MÉDAC

MÉDAC is a unique non-profit organization that is dedicated to financial education, promoting sound governance and the rights and interests of small investors. Its primary means of action are:

- Preparation and defence of proposals at shareholder meetings to ensure that the mechanisms of sound governance are in place to promote corporate rectitude
- Training of its members by developing courses to initiate them to the mechanisms of the financial markets while informing them about strategies to protect and defend their rights
- Tabling of briefs with governments and regulatory authorities to inform them of its members' concerns and make recommendations
- Publication of brochures, flyers, newsletters and other documents
- An alert and information service for members and the general public to guide them and foster their solidarity and prevention instincts

MÉDAC is run by a Board of Directors consisting of Claude Béland, Chair; Fernand Daoust, Vice-Chair; Louise Champoux-Paillé, Board Secretary; Jean Legault, Treasurer; and the following additional members: Louise Charette, Monique Charland, Clément De Laat, Yves Michaud, Réjean Ross and Daniel Simard.

Since MÉDAC was founded, we have filed over sixty proposals on the themes of sound governance, compensation and shareholder participation (see Appendix I for the list of proposals). Our association has presented the largest number of proposals in Canada. We have therefore contributed to substantially improving governance within organizations, as shown by the following two studies:

- Les propositions d'actionnaires, pilier de saine gouvernance (Shareholder proposals, the pillar of sound governance, Appendix II)
- Le vote consultatif et ses impacts (the "say on pay" vote and its impacts, Appendix III)

Our member roll today comprises nearly 1,600 committed members who support us in our representation and reflection efforts.

Empowered by our membership base and daily contacts with numerous consumers of financial products and services, we have prepared the following comments and recommendations which, we hope, will prove useful throughout your review.

## General recommendation

Since MÉDAC was founded, one of our key vectors for intervention has been defending the principles of equity and of aligning executive compensation with the organization's long-term objectives. Over the years, we have initiated major changes, particularly with respect to the independence of compensation committees and compensation experts, greater transparency in the disclosure of the experts' fees, and greater participation by minority shareholders in setting compensation policies, with the adoption and implementation of the "say on pay" vote.

The recent financial crisis spotlighted the role played by inadequate compensation structures. Compensation policies that reward risk-taking beyond the general level of risk tolerated can impede sound, efficient risk management for a company and exacerbate reckless conduct.

Moreover, the compensation packages of senior executives have been growing steadily, with no clearly demonstrated link between performance and the long-term value added they generate. Unsurprisingly, in this climate, over 50% of the shareholders of financial institutions have cried out against this situation and demanded a say on executive compensation policies. The dissatisfaction continues: a review of readers' opinions after the publication of the gaps between how much CEOs are paid on average and a worker's average earnings confirms the indignation felt by most Quebeckers and Canadians on the unconscionability of this situation.

Given the magnitude of the problem, the main changes proposed by the CSA fall far short of our expectations. For us, it is essential that regulatory bodies play their role of overseeing and defining the basic principles for sound compensation so that the compensation structure does not encourage excessive risk-taking and is in line with the company's propensity for risk, values and long-term interests. What's more, it is important for regulatory authorities to express their strong concerns regarding compensation that is based on performance measures primarily associated with financial indicators, as they introduce biases that could, in the long run, reawaken the behaviours that led to the recent financial crisis. Authorities must steer business toward new paradigms that promise fundamental change in how compensation policies are formulated. Here are a few of the principles we favour:

- Alignment of executive performance criteria with the organization's long-term objectives, both financial and non-financial
- Equity towards all employees by respecting a pre-established ratio between the compensation paid to the most senior executive and the median compensation paid to employees; the ratio should never be greater than 30 times an employee's median compensation
- Shareholder participation, by means of an annual "say on pay" vote, with respect to executive compensation and compensation paid upon a change in control (golden parachutes)
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- Consideration of risk in evaluating executive performance to ensure sound, efficient management of risks in the corporation and discourage excessive risk-taking
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- Have all variable compensation subject to the achievement of specific objectives

Unless such principles are enshrined in the regulations, this type of review exercise will be pointless.

*Discussion of the main changes proposed by the CSAs*

**Exemption from the obligation to disclose performance objectives or similar terms in the event of serious prejudice**

This type of exemption can become an easy loophole, as, based on the suggested modifications, a corporation that uses such an exemption need only communicate the reasons it thinks such a disclosure

would be seriously prejudicial to its interests. We believe that such an exemption should only be granted on yearly written authorization from the regulatory authority, with a mention in the management circular, and based on criteria that the regulatory authorities have defined beforehand, so that the market will have an idea of the probable reasons for non-disclosure, making the exemption less attractive to the company.

**Obligation to state whether the board of directors has considered the consequences of the risks associated with the company's compensation policies and practices**

This disclosure obligation will provide shareholders with useful information for assessing whether the board of directors has considered the risks associated with the company's compensation policies and practices. Moreover, we believe that regulatory authorities should demand disclosure of a report from an independent risk management expert certifying the rigorousness of the process regarding practices used to detect and mitigate compensation policies and practices that are likely to encourage the executives involved or persons at a primary operating unit or division to take excessive risk.

**Disclose whether an executive or officer is authorized to buy financial instruments designed to hedge against a decline in the value of equity securities received as compensation, or which he holds, directly or indirectly, or to offset such a decline**

The possibility of resorting to financial instruments to enable executives to shield themselves from a decline in the value of the security should be prohibited, as in the European Community's CRD III.

**Disclosure requirement for compensation advisors: description of the mandate and breakdown of amounts for each service rendered**

Here, we reiterate that our position leans toward having the compensation expert draw most of his fees from the company for his advisory mandate with the board of directors and its compensation committee, to have the compensation expert be as independent as the external auditor is in terms of his work. If regulators really wish to respond to the concern with independence, they must impose this principle. The additional disclosure obligations suggested provide for greater transparency, but not the expert's independence.

Moreover, it also seems essential to disclose the following additional information:

- The number of company shares held by the compensation expert or his firm
- Any business relationship between the compensation expert and a member of the board of directors, let alone a member of the compensation committee, or with companies with which board members have professional relationships
- What percentage the fees paid for advisory mandates for the board of directors represent in terms of total fees paid to the expert and his firm by the company

**Impossibility of modifying the compensation presentation table**

This table makes it possible to standardize how the information is presented and facilitate comparisons. Any change makes it harder to read and could lead to a misunderstanding of the situation or poor decisions. We therefore believe that the modification to oblige companies to comply with prescribed disclosure formats is important.

**Obligation to communicate the method used for calculating the fair value as at the date of award for all awards based on equity securities, including key assumptions and estimates used for the calculation and the reasons for selecting this method, regardless of whether the value differs from fair book value**

We support the recommendation to consolidate all of this information in the management circular, with appropriate explanatory remarks in simple, clear language that will allow investors to better assess the value of these compensation instruments.

**Declaration of any contribution paid by the company on behalf of an executive, including the non-remunerative portion of a personal RRSP to which an executive contributes**

The investor must have a clear idea of all of the kinds of compensation given to senior executives. From this perspective, we support the modification requiring disclosure of every contribution paid by a company on behalf of a senior executive. Moreover, we consider useful and essential the information on the non-remunerative amount of defined contribution plans to which a senior executive can opt to contribute by means of payroll deductions. Suppressing this information would materially reduce the level of transparency with respect to information on corporate commitments to pension plans.

**Amount realized upon the exercise of allotment rights based on equity securities**

To better assess the scope of compensation given to executives with respect to allotment rights based on equity securities, for us, it is essential that regulators reintroduce the obligation to report the total value realized upon the exercise of options or stock appreciation rights (SAR) in the management circular. It makes it possible to compare an executive's medium- or long-term compensation with the company's overall performance during this period, and spotlight the impact of the compensation policy implemented several years ago.

Although this information is available on the System for Electronic Disclosure by Insiders (SEDI), the investor must, for each executive involved, add up the number of options exercised during the fiscal year; establish, for each transaction, the difference between the exercise price and the price of the stock at the time of exercise; and, lastly, calculate the value of the compensation awarded to the executive in this form.

As transparency is one of the values sought by continuous disclosure obligations, we cannot support a policy that makes it more onerous to get information that is crucial to investors who are now required to take a stand on executive compensation.

**Disclosure using comparison groups**

Studies show that disclosing compensation has perversely resulted in fuelling a constant rise in executive compensation. More specifically, a recent study shows that 50% of the increases in

compensation for U.S. presidents and CEOs from 1992 to 2006 have been triggered by the one-upmanship created by the benchmarking system

Other researchers have shown that corporations tend to use comparison groups in which executive compensation is often higher than the compensation of their own executives. This approach is harmful to the sound relationship that must exist between compensation and the organization's performance.

Currently, shareholders have little information on the choice of the comparison universe or on the company's positioning in relation to its peers:

- Company's rank among corporations that the compensation committee has identified as comparable with respect to each component of compensation and total compensation for the five primary leaders
- Company's rank in relation to its peers based on various financial performance indicators

Shareholders also have little information on the importance the compensation committee places on these figures in the compensation setting process: choice of the comparison universe (national or international), percentile rank targeted, for which components of compensation.

We think that it is essential for this information to be included in the information provided with the compensation policy. It is crucial to understand the impacts of such a compensation-setting tool on setting compensation for executives; the tool must be benchmarked by use of an ethically and socially acceptable internal equity ratio.

## CONCLUSION

Given the role that compensation structures played in the recent financial crisis, we believe that regulatory authorities must promote in-depth change in how such structures are designed, so that investors are assured that they no longer encourage excessive risk-taking and are compatible with companies' propensity for risk, values and long-term interests.