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Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Government of Yukon
Registrar of Securities, Department of Justice, Government of the Northwest Territories
Registrar of Securities, Legal Registries Division, Department of Justice, Government of Nunavut

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Request for Comment - Proposed Amendments to Form 51-102F6, *Statement of Executive Compensation* and Consequential Amendments

We would like to thank the Canadian Securities Administrators (the CSA) for this opportunity to provide comments on the **Proposed Amendments to Form 51-102F6, *Statement of Executive Compensation* and Consequential Amendments**.

The Shareholder Association for Research and Education (SHARE) is an advisor to Canadian institutional investors. Since its creation in 2000, SHARE has provided proxy voting and

shareholder engagement services as well as education, policy advocacy and practical research on emerging responsible investment issues.

SHARE has previously made submissions in response to CSA requests for comments on amendments to Form 51-102F6 in 2007 and 2009.

Overall, we are supportive of the efforts the CSA is making with its proposed amendments to provide boards with more guidance regarding the requirements under 51-102F6. Shareholder assessments of compensation committee performance and the increasing prevalence of say on pay votes on Canadian company ballots[1] make clear and complete exeuctive compensation disclosure critically important to shareholders. Increasing the specificity of the disclosure requirements will help boards to avoid a circumstance in which shareholders vote against the company`s approach to exeuctive compensation due simply to lack of complete information rather than because they are opposed to the board`s decisons on NEO compensation.

We offer the following responses to the specific questions the CSA has provided in the Request for Comments.

Risk management in relation to the company's compensation policies and practices

1. **Would expanding the scope of the CD&A to require disclosure concerning a company's compensation policies and practices as it relates to risk provide meaningful disclosures to investors?**

Yes. Investors assess executive compensation programs and policies in order to form an opinion about how likely it is that they will motivate executives to increase the company's risk exposure in order to meet compensation targets or otherwise maximize their pay. The board's view on this question would clearly be helpful to investors as they assess the board's performance in structuring and awarding compensation to executives in order to vote on the proposed directors and say on pay resolutions.

2. **Is the commentary of the issues that a company may consider to discuss and analyze sufficient?**

[1] As of Feburary 8, 2011, 46 Canadian issuers have agreed to hold say on pay votes. In 2010, a total of 28 such votes were held.

One criticism of the Securities and Exchange Commission's very similar 2009 proposal that boards consider the increase in the company's risk exposure as a result of issuers' executive compensation policies was that it would prompt boards to reject all risk in executive compensation programs, and thus cause them to fail to approve programs that motivate top management.[2] We would argue that boards routinely consider risk with respect to executive compensation schemes from precisely this perspective. Most boards indicate that they are concerned about failing to provide sufficient pay, and particularly sufficient and effectively structured 'at risk' pay, to attract and retain the expertise the company requires to perform well. In our view, boards will have an opportunity to consider a broader range of potential risks that executive compensation policies and practices may pose to the issuer as a result of the CSA`s proposed Item 2.1(5).

We believe that the points set out in Commentary 4 to Item 2.1 will provide boards with very useful terms of reference for this expanded compensation risk analysis. Below, we suggest two additional comments that we believe will provide further assistance to boards. We recommend that boards be provided with a more structured framework than that set out in the proposed commentary in order to assist them with their evaluation of risks associated with the company's compensation policies and practices.

We suggest that some of the considerations set out in the Commentary be formulated as required disclosure. We believe there are two important reasons why specific disclosures are warranted as an accompaniment to the Commentary. First, specific disclosures under Item 2.1(5)(c) will provide reference points for boards as they perform an analysis of the potentail risks arising as a result of executive compensation policies and practices. We also believe that just as shareholders may form an opinion that differs from boards on matters such as the independence of a director, they may disagree with a board that concludes that an issuer's compensation policies and practices are not reasonably likely to have a material adverse effect on the company. If shareholders have disclosure with respect to specific situations that may give rise to inappropriate risk taking by NEOs identified by the CSA, they can form their own opinion and compare it to that which the board has formed on the matter.

Three of the examples in the Commentary relate to issuer disclosure the CSA already requires. If an issuer provides complete disclosure in accordance with 51-102F6, the board will disclose information relevant to the following:

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[2] As exmples, see submissions from the American Bar Association, p. 2 online at: http://www.sec.gov/comments/s7-13-09/s71309-152.pdf, and Towers Perrin, p. 9 online at: http://www.sec.gov/comments/s7-13-09/s71309-46.pdf.

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Bullet 3: Compensation policies and practices that do not include effective risk management and regulatory compliance as part of the performance metrics used in determining compensation;
Bullet 6: Compensation policies and practices 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,
Bullet 7: Compensation policies and practices that contain performance goals or similar conditions that are heavily weighed to short-term rather than long-term objectives.

Two of the examples of situations that could encourage executive officers to take inappropriate or exessive risks that could materially increase the risks to the company have to do with the significant differences between compensation policies and practices of different employee groups within the company:

Bullet 2: Compensation policies and practices for certain executive officers that are structured significantly differently than other executive officers within the company; and,
Bullet 5: Compensation policies and practices that vary significantly from the overall compensation structure of the company

We recommend that issuers completing 51-101F6 be required to produce 'pay ratio' disclosure. This disclosure would set out the relative pay of three categories of company personnel: (i) the CEO; (ii) the five executives (including the CEO) who are identified as the NEOs in its proxy circular and (iii) the average pay of non-executive employees of the company and its subsidiaries globally.

Interest in the ratio is generally based on the view that the pay gap has implications for organizations, their employees and other stakeholders. There is academic evidence that significant gaps between pay at the top and average pay can have a variety of negative impacts on public companies. A recent study[3] found that when corporate employees assess the fairness of their own wages, the pay of the company's CEO is a key point of comparison. The authors found that the less fair non-CEO employees believe their pay to be relative to that of the CEO, the more likely they are to leave the company.

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[3] *Overpaid CEOs and Underpaid Managers: Fairness and Executive Compensation*, James B. Wade, Charles A. O'Reilly, III, Timothy G. Pollock, 2006

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Another example in the comments of a situation that could encourage executive officers to take inappropriate or exessive risks that could materially increase the risks to the company concerns the magnitude of NEO compensation in relation to the company's revenue:

> Bullet 4: compensation policies and practices where the compensation expense to executive officers is a significant percentage of the company's revenue.

Some Canadian issuers currently provide cost of management ratio (COMR) disclosure which is the ratio of total NEO pay to net income after tax.[4] We recommend that the CSA require issuer disclosure of COMR because it is a measure already in use in the Canadian market that is directly relevant to the CSA's specified situation set out in the Commentary for board consideration.

Finally, we have concerns about the structure of proposed Item 2.1(5). An issuer is required to disclose whether or not it has considered the implications of the risks associated with its compensation policies and practices, and, if it has done so, provide information about those considerations and the board's involvement in them. The difficulty arises in 2.1(5)(c), the requirement that an issuer disclose any risks it has identified that are reasonably likely to have a material adverse effect on the issuer. Subsection (c) disclosure and the Commentary are limited to compensation arrangements so poor that they threaten to have a negative impact on the issuer's business. This is the only circumstance in which discussion of specific aspects of compensation policies and practices are invited through the Commentary.

We are concerned that the structure of 2.1(5) will essentially stigmatize disclsoure regarding the specific, potentially probematic aspects of compensation set out in the Commentary. For this reason, we recommend that 2.1(5)(c) be redrafted to make clear that discussion of these matters should be disclosed even if the board has not identified any compensation policies and practices that are reasonably likely to have a material adverse effect on the issuer.

3. **Are there certain risks that are more clearly aligned with compensation practices the disclosure of which would be material to investors?**

We believe that any incentive scheme that does not have a maximum benefit or "cap" presents the potential for significant risk to an issuer. Compensation programs without an upper limit may encourage an executive to adopt a "go for broke" approach aimed at

[4] In 2010, these issuers included Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, Industrial Alliance Insurance and Financial Services Inc., Manulife Financial Corporation, Royal Bank of Canada and The Toronto-Dominion Bank.

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maximizing payouts of such awards without attentiveness to any risks this approach may present for the issuer.

4. Are there any other specific items we should list as possibly material information?

We believe there are two compensation practices not set out in the proposed Commentary that boards should consider when they evaluate the potential risks to the company of their compensation decisions.

(i) The use of discretion to adjust NEO compensation after it is determined under previously approved criteria.

Such discretion is often given very brief mention in proxy materials. We are not of the view that discretionary changes to compensation outcomes are invariably inadvisable. We do believe that if discretion is exercised without a cogent rationale, it produces uncertainty for issuers, NEOs and shareholders. If NEOs anticipate that performance will be rewarded in accordance with specified expectations only to find that adjustments are made after the fact that are not adequately explained, uncertainty about expectations may create signficant risk. A full explanation should be required.

(ii) Including CEOs of other issuers on the compensation committee.

CEOs clearly have significant expertise in being compensated. We believe this expertise is ill-suited to the task of awarding compensation to a fellow CEO. CEOs on compensation committees may have conflicts of interest in setting the pay of other chief executives, viewing risk oversight and mitigation as unnecessary fetters to strong leadership.

(iii) Absence of ESG performance considerations and criteria from determination of NEO incentive compensation.

An issuer that links environmental, social and governance (ESG) performance to the pay of its top executives signals an appreciation of the broad range of risks NEOs must manage over the long term. The linkage is critical because ESG performance is often understood by market participants to encompass “non-financial” matters. There is growing recognition that toxic spills, lost-time injuries, labour standards litigation, the regulation of high environmental impact activities and related occurrences carry the real risk of becoming astronomically costly to issuers and therefore to investors. Failure to incentivize ESG risk management and reduction is a significant source of compensation policy risk.

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Disclosure of fees paid to compensation advisors

5. **The proposed disclosure requirement calls for disclosure of all fees paid to compensation advisors for each service provided. Should we impose a materiality threshold in disclosing the fees paid to compensation advisors based on a certain dollar amount?**

No, a dollar amount disclosure threshold should not be added to 2.4(3).

We examine issuer disclosure with respect to compensation consultants as part of our assessment of director nominees who serve on compensation committees. Information with respect to compensation consulting firms retained by the board and, where applicable, management, is key to a complete analysis.

We relied on the disclosure provided by S&P/TSX Composite Index issuers (Composite issuers) in 2010 to assess the CSA's proposed Item 2.4(3).[5]

In 2010, approximately 70% of S&P/TSX Composite Index issuers (Composite issuers) reported that their board retained one or more firms to provide compensation consulting services.[6] There is certainly evidence from the 2010 proxy circulars that Composite issuers are sensitive to concerns (including no doubt their own) about the independence from management of compensation consultants retained by the board. Of the Composite issuer boards that reported retaining compensation consultants in their 2010 proxy materials, approximately 23% indicated that the compensation consultant retained by the board performed no work for management.

A slightly larger group (26%) indicated that although the compensation consulting firm retained by the board may also act for management, a board level review is required before the firm the board retains can provide services to management.[7]

[5] S&P/TSX Composite Index consituents as at March 22, 2010.

[6] 27% of the issuers reported that no compensation consultants were retained in 2009. 3% provided no disclosure with respect to compensation consultants beyond an indication that the compensation committee had the power to retain such advisors.

[7] One of these issuers applies a 'financial independence test', under which a consulting firm will be considered independent of management if the fees it earns for work assigned by management makes up less than a specified percentage of the consulting firm's annual revenue.

We prefer that the board's compensation consulting firm be completely independent of management. When a consulting firm retained by the board may also, with or without board review, provide services to management we require complete fee information with respect to all services rendered so that we can assess the potential for conflict of interest. When the compensation consulting firm acts only for the board, disclosure of the firm's fees is useful to us in our assessment of the issuer's compensation policies and practices.

Based on the disclosure provided by Composite issuers in 2010, approximately 73% of issuers that retained compensation consultants reported the dollar amount of fees paid for such services. Of the Composite issuers that retained compensation consultants and disclosed the fees paid to them, just 14% indicated that the fees paid by management for the relevant year were in excess of $120,000. [8]

Fees paid by the company for compensation consultants retained by management and the board are in some cases modest in dollar terms, yet billed primarily for management mandates. One issuer reported that a firm's fees in excess of $70,000 were billed to management by a consulting firm that provided services to the board's compensation committee for fees of less than $5,000.

The threshold that applies to the disclosure of perquisites under the existing Form 51-101F6 is reasonable. Tabulating perquisites requires tracking and in some cases determining aggregate incremental cost to the issuer of multiple items of relatively low dollar value. Compensation consulting fees, by contrast, have a specified value and are unlikely to require tracking more than a few invoices.

For the reasons set out above, we believe that a dollar amount disclosure threshold for compensation consulting fees is not appropriate. Fee disclosure should be required with respect to all such services rendered.

Non-compensatory amount for defined contribution pension plans

6. **Does the disclosure of the non-compensatory amounts for defined contribution plans that an NEO may elect to make with funds received from their salary (currently required by subsection 5.2(3)) provide appropriate and relevant information for an investor?**

[8] The threshold for such disclosures under Item 407 of Regulation S-K.

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We do not object to the elimination of the requirement set out in subsection 5.2(3).

7. **If we removed column (d) of section 5.2, which would limit the disclosure to the compensatory amounts such as employer contributions and above-market or preferential earnings credited on employer and employee contributions, would this provide adequate transparency of a company's pension obligations to its NEOs?**

Yes.

Amounts realized upon exercise of equity awards

We acknowledge the CSA's view that executive compensation disclosure requirements should "focus on the board's compensation-based decisions, rather than the executive officer's investment decisions". We believe, however, that executive compensation disclosure should not be a walled garden in this respect. We would hope that boards are interested in the amount of compensation ultimately realized by NEOs as a direct result of the decisions of the issuer and the board to establish equity based compensation plans. We know that shareholders are interested in these outcomes.

Issuers and boards establish compensation plans which result in NEO pay amounts that cannot be known at the date of grant. The issuer decision to establish such plans should not exempt the resulting compensation amounts from disclosure in the proxy materials.

In its Request for Comments, the CSA notes that "the information to calculate gains on the exercise or sale of equity-based awards is available on SEDI and can be calculated for individual NEOs". This would require thousands of shareholders to perform multiple searches and calculations when each issuer could complete this work once for its five NEOs, presumably without the need to resort to SEDI.

Thank you for the opportunity to comment on these proposals. Should you require any clarification of the points raised above or additional supporting information, please do not hesitate to contact the undersigned.

Sincerely,

Laura O'Neill
Director of Law and Policy