Submission by the Canadian Labour Congress to the Ontario Securities Commission

OSC Staff Notice 54-701

Regulatory Developments Regarding Shareholder Democracy Issues

March 31, 2011

Canadian Labour Congress
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Executive Summary

On behalf of the 3.2 million members of the Canadian Labour Congress (CLC), we want to thank you for affording us the opportunity to present our views. The CLC brings together Canada's national and international unions along with the Provincial and Territorial Federations of Labour and 130 District Labour Councils whose members work in virtually all sectors of the Canadian economy, in all occupations, in all parts of Canada.

The CLC recommends that the Ontario Securities Commission (OSC) require mandatory advisory votes on executive compensation for all public issuers in Ontario. In order to ensure a meaningful shareholder vote, the OSC should ensure that company compensation committee reports forming the basis of advisory votes meet a high standard of completeness and clarity. In addition, the OSC should facilitate majority voting for individual director nominees.

Executive Compensation and Income Inequality in Canada

The starting point for any discussion about restricting excessive remuneration among executives of publicly-listed companies must be an acknowledgement of the growing inequality in income distribution in Canada over the past three decades. Reversing a thirty-year trend toward greater equality over the post-World War Two era, the rapid growth in earnings of those at the very top of the income spectrum has given rise to a growing income gap in Canada. Despite continued productivity growth, real incomes of the vast majority of income earners

have remained stagnant. Between 1987 and 2007, the top 1% of income earners received a third of total gains in income in Canada.[1] Not only is growing income inequality an impediment to economic growth and corrosive to political democracy, there is evidence that it fosters financial instability and systemic fragility, increasing the risk of more frequent and severe financial crises.[2]

During the expansion of the US housing bubble and amidst the financial excesses of the late 2000s, executives in the financial, insurance and real estate industries commonly received stratospheric compensation packages. Amidst the crisis, public outrage sparked greater attention among regulators and policymakers to the misalignment of executive compensation practices, the lack of transparency in reporting, and the dearth of mechanisms to ensure shareholder oversight of company compensation practices.

Despite having temporarily attracted the attention of the media and the ire of policy makers, concern over executive compensation practices has subsided and firms appear to have returned to business as usual. Indeed, the economic recession had little impact on the high remuneration enjoyed by top CEOs and directors in Canada. In 2009, amidst the economic downturn, the average earnings of Canada's 100 highest paid CEOs were 155 times that of a Canadian worker earning the average income, up from a ratio of 104 times in 1998.[3] Compared to the total average income in Canada of $42,988, Canada's 100 top paid CEOs enjoyed total average compensation of $6,643,895 in 2009. Well before CEO compensation packages reached these heights, a 2004 survey

1 Armine Yalnizyan, *The Rise of Canada's Richest 1%*, Canadian Centre for Policy Alternatives, December 2010.

2 Michael Kumhof and Romain Rancière, *Inequality, Leverage and Crises*, International Monetary Fund Working Paper WP/10/268, November 2010

3 Hugh Mackenzie, *Recession-Proof: Canada's 100 Best Paid CEOs*, Canadian Centre for Policy Alternatives, January 2011.

jointly sponsored by McKinsey and the Canadian Coalition for Good Governance survey found that approximately 40% of board members and 65% of investors in Canada already concluded that CEO compensation is too high.[4]

OSC Proposals on Shareholder Democracy Issues

In the context of the 2008 financial crisis, the Ontario Standing Committee on Government Agencies recommended that the Ontario Securities Commission look into the issues of shareholder democracy. With its current review of shareholder democracy issues, the OSC is now playing catch-up to existing shareholder proposal campaigns in Canada, the United States and internationally. In Canada, nearly 50 companies have already agreed to adopt advisory votes on executive compensation, and in the United States, shareholder proposals for advisory votes on executive compensation have been spreading for the past several years. Indeed, there is evidence that non-binding votes on executive remuneration are becoming generally accepted in Canada and the OECD as best practice in corporate governance for publicly-listed companies.

Many other jurisdictions now have rules requiring a shareholder "say-on-pay". Since 2003 in the United Kingdom and 2004 in Australia, the compensation policy of public corporations must be submitted to a non-binding vote by shareholders. Beginning in 2011, the United States *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank) will require virtually all publicly held companies to include an advisory say-on-pay vote, in addition to a separate vote on the frequency with which subsequent say-on-pay votes will be conducted. As well, where shareholder approval of mergers or acquisitions by public issuers is sought, company proxies must quantify the compensation contained in

4 Canadian Coalition for Good Governance, *Good Governance Guidelines for Principled Executive Compensation*, Working Paper, June 2006.

"golden parachute" payments to its executive officers and an advisory vote must be conducted.

In Canada, a significant minority of public companies provide shareholders with a say-on-pay, but there is no mandatory advisory say-on-pay vote for issuers. The CLC supports the initiative to require shareholder voice in the determination of top executives compensation. Regulatory action is needed to allow shareholders in all publicly-held companies to exert oversight on compensation packages; waiting for firms to voluntarily adopt say-on-pay measures will limit their impact, since firms will contend they are at a competitive disadvantage if they implement measures that potentially restrict executive compensation.

While the CLC supports a mandatory say-on-pay, there is no reason to believe a non-binding vote alone will improve transparency and disclosure, or halt the upward drift of executive compensation.[5] Despite the existence of advisory votes at Canada's largest banks, there is scant evidence that executive compensation is being held in check.[6] In spite of the introduction of non-binding advisory votes in Australia in 2005, directors went ahead with remuneration proposals in the face of negative shareholder votes, leading to proposals to strengthen the consequences flowing from shareholder advisory votes.

5 David Milstead, "Say on Pay Doesn't Guarantee Smaller Pay Packets," *Globe and Mail* 4 December 2009.

6 Tara Perkins, "RBC's Gordon Nixon Paid $11-Million in 2010," *Globe and Mail* 7 February 2011;
Grant Robertson, "TD Chief's Compensation Rises 8 Per Cent," *Globe and Mail* 23 February 2011;
Grant Robertson, "Scotiabank's Rick Waugh Earns $10.7-Million," *Globe and Mail* 28 February 2011;
Grant Robertson, "BMO Head Bill Downe Takes Hefty Raise," *Globe and Mail* 28 February 2011;
Grant Robertson, "CIBC's McCaughey Gets 50% Pay Raise," *Globe and Mail* 17 March 2011.

While eschewing a binding vote, the Australian government has introduced measures to ensure greater transparency and accountability to shareholders.[7] The proposed changes to Australia's *Corporations Act* would supplement the existing non-binding vote on executive compensation with a "two-strikes and re-election" process. If the remuneration report receives a "no" vote of 25% or more, the company's next remuneration report must explain either that shareholders' concerns have been addressed (and how), or why they have not been taken into account.[8] If this subsequent year's compensation report receives a "no" vote of 25% or more, shareholders vote to decide whether to force the directors to stand for re-election within 90 days. Fifty percent or more is required to pass this resolution and trigger an election meeting.

The CLC recommends adopting measures such as the Australian proposals to put real force into shareholder review of executive compensation practices.

Finally, individual director voting, instead of slate, and majority votes are a minimal reform that should be mandatory in Canada, closely linked as they are to the effectiveness of any say-on-pay vote.[9]

7 The Netherlands and Norway have in the last decade adopted requirements for binding shareholder votes to approve compensation policies of companies.

8 Dodd-Frank also requires that the subsequent Compensation Discussion and Analysis of a company's proxy explain whether and the extent to which compensation arrangements have changed to reflect shareholder votes.

9 Davies Ward Phillips & Vineberg LLP, *The Quality of the Shareholder Vote in Canada*, Discussion Paper, October 22, 2010.

Transparency and Disclosure

Section 953(a) of *Dodd-Frank* requires that proxy materials include "a clear description" of executive compensation. If remuneration is to be properly aligned with long-term performance, the components of executive pay packages must be clearly defined in order to reveal any and all stock options, bonuses or other rewards tied to short-term profits and risk taking, with potential long-term losses for investors and taxpayers. It is necessary that issuers' compensation committee reports contain complete and clearly presented information that does not understate the true value of stock options and other elements of executive remuneration on which shareholders are to vote.

The CLC also recommends that the OSC adopt measures to ensure the independence of compensation committees, including scrutinizing the independence and any conflicts of interest of consultants and advisors to the compensation committee.

Section 953(b) of *Dodd-Frank* requires disclosure of the ratio of the CEO's annual total compensation to the median annual total compensation of employees. Extending beyond the more limited objective of aligning executive compensation with company performance, this measure is intended to cast light on an important dimension of growing inequality, the widening gap between the earnings of corporate executives, and the wages and salaries of the vast majority of workers. The CLC recommends that this requirement be made mandatory in Ontario as well.

Concluding Comments

In the absence of concerted reforms to social, economic and labour market policy, efforts to strengthen accountability to shareholders are

unlikely to halt or reverse the upward march of inequality in Canada. Nevertheless, the CLC believes that providing investors with more effective instruments to discourage egregious and self-aggrandizing behaviour among top executives is an important and welcome step in this direction.

This document is respectfully submitted on behalf of the Canadian Labour Congress:

Kenneth V. Georgetti
President

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