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Say on Pay in Canada

Have you seen this on a proxy form lately?

Advisory vote on Co. X's Approach to Executive Compensation For Against

Lately, proxy forms in Canada are now including this "Say on Pay" voting option for upcoming shareholder meetings. Examples of these proxy forms can be found on www.sedar.com where they have been adopted by approximately 19 Canadian companies, such as the Royal Bank of Canada and the TMX Group Inc., as outlined in their respective Management Information Circulars.

"Say on Pay" refers to the annual shareholder **advisory vote** on executive compensation. While this is a new phenomenon in Canada, similar initiatives have been in place in the UK and several European countries for several years. The primary objective of Say on Pay is in increased transparency of decisions about compensation and better alignment of director pay with performance, which are all key issues of importance to boards. Discussion of how an issuer's compensation policies and practices address these aims will be central to complying with the new executive compensation disclosure requirements, particularly the compensation discussion and analysis (CD&A) required in information circulars this year. Issuers that meet these new standards of disclosure should be well positioned to respond to shareholder concerns at upcoming annual meetings, whether or not the issuer has adopted the advisory shareholder vote on compensation.

What are the pros and cons of including the Say on Pay vote?

Pros:

- The current shareholder mechanisms for expressing dissatisfaction with executive compensation matters – such as withholding votes for the election of an individual director are not very effective.
- This an efficient way for shareholders to express their views of the board's executive pay. Instead of shareholders taking more drastic steps such as attempting to replace sitting directors, Say on Pay provides a happy medium. The existence of a shareholder vote may have the impact of moderating the proposed board compensation decisions.
- Other countries that have adopted Say on Pay for a number of years, have had no major business disruptions and are satisfied with the results. In the US, of six companies that submitted their pay program to a vote in 2008, only one received less than 90% support. In 2009, results averaged less than 90%.

Cons:

- Executive compensation is a complicated issue and that a simple yes/no non-binding vote does not provide a board with any meaningful information about the shareholder's views on executive compensation.
- It can be argued that setting executive compensation is the duty of the directors. A shareholder vote can only muddy the respective roles of the shareholders and the directors and reduce the accountability of the board. Some say that the board of directors could even be led to adopt plans based on optics rather than effectiveness.
- Shareholders already have the ability to express their disapproval about compensation matters via the shareholder proposal mechanism or by voting against or withholding their votes for the election of directors (when there is no slate voting).
- Non-binding shareholder votes could lead to legal uncertainties.

Further Updates

The **Canadian Coalition for Good Governance** (ccgg) www.ccgg.ca

The Canadian Coalition for Good Governance has over 45 institutional investor members who cumulatively manage over \$1.3 trillion of assets. Since their inception in 2003, ccgg has worked hard to improve the corporate governance of the issuers in which their members invest. In their, **Model Shareholder Engagement and "Say on Pay" Policy of Boards of Directors**, ccgg recommends that the board adopts a similar policy to what they have outlined...

“In order to allow shareholders to provide timely and meaningful feedback to the board, the board will develop practices to increase engagement with all of its shareholders as is appropriate for its shareholder base and size. Examples of engagement include meeting with the company’s larger shareholders and organizations representing a number of shareholders and establishing methods of hearing from smaller shareholders on an ongoing basis. The board will also consider emerging shareholder engagement practices in other jurisdictions as they develop, such as asking specific questions as a part of the proxy process, holding “town hall” meetings, undertaking investor surveys and using web-based tools that allow shareholders to provide feedback and/or ask questions of the board.

Advisory “Say on Pay” Vote

The board believes that shareholders should have the opportunity to fully understand the objectives, philosophy and principles the board has used in its approach to executive compensation decisions and to have an advisory vote on the board’s approach to executive compensation.

Purpose of “Say on Pay” Advisory Vote

The purpose of the Say on Pay advisory vote is to provide appropriate director accountability to the shareholders of the company for the board’s compensation decisions by giving shareholders a formal opportunity to provide their views on the disclosed objectives of the executive compensation plans, and on the plans themselves, for the past, current and future fiscal years.

While shareholders will provide their collective advisory vote, the directors of the company remain fully responsible for their compensation decisions and are not relieved of these responsibilities by a positive advisory vote by shareholders.

Form of Resolution

The management information circular distributed in advance of each annual meeting of shareholders will ask shareholders to consider an annual non-binding advisory resolution substantially in the following form:

Resolved, on an advisory basis and not to diminish the role and responsibilities of the board of directors, that the shareholders accept the approach to executive compensation disclosed in the Company’s information circular delivered in advance of the [insert year] annual meeting of shareholders.

Approval of the above resolution will require an affirmative vote of a majority of the votes cast at the annual meeting of shareholders.

RiskMetrics Group provides a comprehensive proxy research to some of the world’s largest and most important financial institutions and they will generally support non-binding shareholder advisory votes on pay, as a mechanism for shareholders to register approval or disapproval of compensation arrangements. More information about RiskMetrics policies can be found at their policy gateway at www.riskmetrics.com/policy.

Who’s Adopting Say on Pay?

SHARE (Shareholder Association for Research & Education) is maintaining a list of issuers who have adopted a Say on Pay vote. The learn more about SHARE go to www.share.ca.

What is means for Issuers?

If you are a public issuer that has not adopted Say on Pay, directors and members of management should be prepared to address Say on Pay at upcoming shareholder meetings, whether or not the issuer has received a specific shareholder proposal on Say on Pay.

What does it mean for the investor relations professional?

Be aware of what your shareholders think about your company’s executive compensation and know your company’s plan for the future. If you board agrees to meet with shareholders, ensure they are aware of selective disclosure rules. Work with your Corporate Secretary to prepare a response if a shareholder proposal is received, assuming that the issuer has not adopted a Say on Pay proposal yet.

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