



Remarks on Executive Compensation

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I'm delighted to address an audience of board members and senior executives about the regulator's perspective on the disclosure of executive compensation.

Executive compensation is drawing a lot of public attention. Last November at our "Dialogue with the OSC" conference, David Beatty of the Canadian Coalition for Good Governance said "compensation is *the* big issue" these days.

Everyone likes to talk about executive compensation. And everyone has an opinion.

Many of you know that Warren Buffett is a vocal critic of executive compensation packages in the U.S. Buffett likes to point out that Berkshire Hathaway rewards its own

management with incentives that are always tied to the operating results for which a CEO is given authority.

Buffett says Berkshire Hathaway doesn't issue "lottery tickets" that carry payoffs unrelated to business performance.

In his 2006 Chairman's letter, Buffett also commented on the issue of executive compensation disclosure:

"Irrational and excessive comp practices will not be materially changed by disclosure or by 'independent' comp committee members... Compensation reform will only occur if the largest institutional shareholders – it would only take a few – demand a *fresh* look at the whole system."

Well, I don't know whether Warren Buffet is right or not in his assessment about the impact of disclosure. But I do know that the largest institutional shareholders can only take concerted action if they are armed with the facts – full, true and plain disclosure.

Here in Canada, the Canadian Securities Administrators – the CSA – launched its executive compensation disclosure project in response to an increasing dissatisfaction with our current disclosure requirements. We wanted to improve the quality and the completeness of executive compensation disclosure.

Frankly, the existing requirements are out of date – they were implemented 13 years ago, way back in 1994.

Moreover, some public companies have already started

providing additional disclosure, beyond what's currently required by the CSA.

What's more, the U.S. Securities and Exchange Commission revised its executive compensation disclosure rules last year. The CSA has reviewed the new SEC rules in order to determine what parts are relevant to our markets.

Whether the new SEC rules will affect the prevailing levels of executive compensation in the United States has yet to be determined. But SEC Chairman Christopher Cox attempted to predict the impact last year when he said:

“I have a feeling that when people are forced to undress in public, they’ll pay more attention to their figures.”

In Canada, our new compensation proposals are meant to be wage-disclosure regulations, not wage-control regulations. As such, the focus of my remarks tonight will be on the disclosure of compensation, not on the levels of compensation. It’s not the regulator’s business to try to influence compensation levels.

Let me assure you, the CSA does not want to put a regulator in the boardroom to tell you how much to pay your executives and directors.

My approach tonight is to make some fairly high-level remarks from a regulator's perspective about executive compensation disclosure. I'll try to describe some of the thinking behind the CSA's proposals, which are currently out for comment. Then I really do want to hear what you think. We're joined tonight by some OSC staff and they'll keep track of the opinions that you express about the CSA disclosure proposals.

Tonight, I'm going to speak about three broad issues:

1. The governance perspective on executive compensation disclosure;
2. Key features of the CSA proposals; and

3. The important differences between the CSA proposals and the SEC's new executive compensation disclosure rules.

Compensation and Governance

First, let me make a few general comments – from a governance perspective – about the importance of enhancing the disclosure of executive compensation.

What's the connection between enhancing corporate governance and the disclosure of executive pay?

Good corporate governance can only be achieved if the people in the boardroom have the tools they need to effectively represent and inform the shareholders.

Mandatory disclosure of executive compensation is a tool that's intended to help directors do their job. To paraphrase Judge Louis Brandeis: "sunlight is a powerful disinfectant."

Executive compensation is getting tougher for the owners of public companies to comprehend. Even sophisticated institutional investors have difficulty figuring out all the elements of executive compensation.

Disclosure can't mean providing just numbers. Disclosure also means providing context and clarity about how the numbers were determined.

Members of board HR committees have to be able to make informed, independent assessments. You all know that there can be powerful social conventions in a boardroom and on the HR committee.

When management tables a detailed compensation comparison study – along with compensation proposals for itself – it’s not easy for an HR committee to say “we have a better idea.”

Moreover, the owners of the business – the investors – are entitled to a simple answer to a simple question: How much am I paying the managers of the business – in total?

All of this points to the crucial importance of who's sitting at the boardroom table on behalf of the owners of the public company.

Key Features of CSA Proposals

My second area is to provide some highlights of a few key features of the CSA proposals.

As I just said, shareholders have a right to know whether – and how – directors have linked rewards for senior management to corporate performance.

Shareholders want to know if executive compensation reflects how the company is actually performing – both in

absolute terms and in relative terms. Separating these two can be very tricky for directors and HR committees.

Now, let me highlight some of the key changes in our proposals.

CD&A

I'll start with the “compensation discussion and analysis” section – the CD&A.

The CD&A is a new section to be used by the board to report to the shareholders on the compensation policies and objectives of a public company.

The CD&A takes a principles-based approach that's intended to give issuers the latitude to customize their disclosure to suit their particular process: how they reached conclusions about executive compensation amounts.

We're hopeful that issuers will not abuse this latitude by filling their disclosure document with boilerplate.

If boilerplate disclosure is the result, we regulators are prepared to direct an issuer to take corrective action during our compliance review. That's where we come in.

Summary Compensation Table

The second feature I'll highlight is the proposed summary compensation table.

This table lists all the elements of compensation for each “named executive officer” – the top five – and provides a total-dollar figure for each.

In other words, we’re taking a total compensation approach to the required disclosure.

The items in the summary compensation table must be presented based on their “fair value”. This, of course, includes non-cash items – deferred stock awards, options and the value of defined-benefit pension plans.

I know there are differing views about the appropriate disclosure for non-cash equity awards in the summary compensation table. The debate is between the “grant date

fair value” approach versus the “current year accounting cost” approach.

The CSA proposal requires disclosure on both bases.

I look forward to hearing your views as to which of these two approaches should be used in the summary comp table.

Pension Disclosure

The last new feature I’ll mention very briefly is the disclosure of pension benefits.

What we’re proposing is a requirement to disclose the details of the defined benefit retirement plans for each named executive – including both the annual entitlement

upon retirement and the total actuarial value of the accumulated benefit.

These new disclosure requirements are important because these long tail, deferred entitlements can involve very significant amounts of shareholder money. And they have not been clearly disclosed in the past.

CSA and SEC

This brings me to my third main point: some key differences between our proposals and the new SEC rules, which were implemented last August.

I think you'll find that the CSA approach is substantially similar to that of the SEC. Our approach will create a level

of disclosure that's largely consistent with the SEC through the use of a summary compensation table and an accompanying narrative.

Let's look at a few direct comparisons.

Who should be disclosed?

In Canada, only five "Named Executive Officers" will be disclosed.

In contrast, the SEC is seeking comments on a proposal that would require disclosure for the top five plus up to three additional highly paid individuals.

Will the disclosure have to be certified?

The SEC will require that the CD&A be certified by both the CEO and CFO.

Concerns about this approach were raised in Canada because the CD&A will essentially reflect the decisions of the Board rather than management.

During our consultations, many people said it would be inappropriate for a CEO or CFO to certify the accuracy of their own compensation.

As a result, the CSA does not plan to have a certification requirement in the disclosure document.

What about the requirements for venture issuers?

In our view, the same disclosure rules should apply to all issuers.

The SEC has set out reduced requirements for small business issuers.

However, the CSA proposal does not set out different requirements for venture issuers – other than the fact venture issuers won't have to prepare a performance graph.

Our guidance for the CD&A acknowledges that a venture issuer with a simple compensation structure will have a simpler CD&A.

As I have noted, broadly speaking, the CSA approach is substantially similar to that of the SEC. However, our objective is to develop a policy that suits the Canadian marketplace.

We've tried to base our approach on regulatory principles, not on detailed prescriptive rules.

The new SEC rules and related amendments were more than 400 pages long. Our Notice covers a mere 60 pages.

Conclusion

Ladies and gentlemen, proper disclosure of executive compensation can:

- help the owners assess the stewardship of the company;
- help the owners assess pay for performance; and
- be a tool to improve the overall governance processes in public companies.

In a recent speech, SEC Corporate Finance Director John White stressed the importance of enhanced disclosure of executive compensation. He said:

“As these new, enhanced disclosures are being made, corporate America and its shareholders are taking note. And talking more.”

The SEC is just starting to see the amount of new information that's available to investors through its new rules.

So far, the new disclosure provided in the U.S. has tended to be very lengthy and it's often presented in complex language.

Whether executives and HR committees at U.S. public companies will start to "care more about their figures" remains to be seen.

The CSA's plan is to have a final rule in place by the end of 2007. That timeline would require the application of the new rule to issuers having financial years ending on or after December 31, 2007.

The new requirements would then apply to proxy circulars distributed in 2008.

To repeat what I said earlier, we want full, true and plain disclosure of senior executive compensation for Canadian public companies.

And we feel investors – including your shareholders and your clients – want the same thing.

I encourage you to submit your comments on the CSA proposals. The comment period is open until June 30th.

Input from investors, public companies, their directors and their advisers is invaluable to us. Our proposals are not

carved in stone – we’re looking to you to help us improve the quality and usefulness of executive compensation disclosure.

You can help us develop a final rule that suits the needs of both investors and public company issuers in Canada’s capital markets.

Thank you.

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