



**Watson Wyatt Worldwide Submission on Notice and Request for Comments on the Proposed Repeal and Substitution of Form 51-102F6 Statement of Executive Compensation, Proposed 2008 Amendments to NI 51-102 Continuous Disclosure Obligations, Forms 51-102F2 and 51-102F5 and Proposed Consequential Amendments to MI 52-110 Audit Committees and NI 58-101 Disclosure of Corporate Governance Practices**

## **Introduction**

Watson Wyatt commends the CSA for considering comments made in response to its previously proposed repeal and substitution of Form 51-102F6 and proposed consequential amendments to NI 51-102, which were originally published for comment March 29, 2007. We feel that the original amendments represented a vast improvement over the current rules, as noted in our submission dated June 29, 2007. We believe the most recent proposed amendments address a number of our concerns with respect to achieving a more complete and transparent disclosure. Our comments are provided in the spirit of fully supporting the CSA goal of creating far greater transparency and we are largely in support of the methods by which the CSA seeks to accomplish this goal. Our comments, detailed below, are intended to enhance corporate stakeholders' understanding of and perspective on compensation amounts realized by executives in relation to both compensation opportunities provided and company performance.

The CSA has amended a number of specific questions for consideration based on proffered comments. We have integrated most of our comment in responses to those amendments, with additional considerations noted where applicable.

### **1. General Provisions**

1. *Will the proposed executive compensation form clearly capture all forms of compensation? Have we achieved our objective in drafting a document that will capture disclosure of compensation practices as they change over time?*

Watson Wyatt believes all forms compensation are appropriately captured by the proposed disclosure, and we commend the CSA for maintaining requirements that are not prescriptive and likely to adapt well to future compensation strategies. We think it will be important for the CSA to continue to track changes in this area and continue to be receptive to comments from issuers, investors and the media.

2. *Do you agree with our proposal not to substantially change the criteria for determining the top five named executive officers? Should it be based on total compensation or some other measure, such as those with the greatest policy influence or decision-making power at the organization?*

Watson Wyatt believes that the use of Total Compensation is appropriate in determining the Named Executive Officers (NEOs), though we do not feel that using Total Compensation will notably change the demographics of the NEOs compared to the prior requirements in most cases.

We praise the efforts of the CSA in amending the method of calculating total compensation in order to reduce volatility in the determination of NEOs. However, we still feel that the current approach could cause otherwise innocuous events to change the demographics of those included in the disclosure. This will result in large variations in the NEOs group from year to year, and may, as such, fail to capture the most senior positions in an organization.

We applaud the CSA for requiring companies to use the total compensation that would be reported under column (i) of the Summary Compensation Table for each executive officer as if the executive officer were an NEO for the most recent financial year. We feel that this may reduce some of the volatility with respect to the following:

- artificially high equity award values for executives in the year they become eligible to retire;
- equity granted upon hire;
- special retention grants made to specific individuals;
- large payouts made from a long-term non-equity incentive plan which is not available to newly hired executives; and
- executives with large deferred compensation values or defined contribution pension plan balances.

We do not believe that using the criterion of “those with the greatest policy influence or decision-making power” is appropriate, as most of our clients would have difficulty in applying this judgement. Having a measurable criterion is also important for the shareholders to be provided with unequivocal and non-arbitrary information.

For determining NEOs, we recommend using only salary, bonus, annual incentive and equity awards value. For determining equity award values, we recommend ignoring the accounting obligation to expense the full grant when an employee becomes eligible to retire and provide the flexibility to ignore special grants made in certain circumstances.

## **2. Compensation discussion and analysis (CD&A)**

- 4. Will the proposed CD&A requirements elicit a meaningful discussion of a company’s compensation policies and decisions?*

While most of our clients already provide meaningful discussion on compensation policy and decision, we have seen instances where improvement is needed. We think that the CD&A requirements will help in these cases, provided regulators proactively track the compliance with the rules. Experience in the United States shows that guidance from the regulator is required in establishing a meaningful CD&A. We recommend implementing a tracking, grading and reporting mechanism for compliance. We agree with the decision to recommend the use of plain language and the avoidance of boilerplate language for companies.

- 5. Should we require companies to provide specific information on performance targets?*

Many of our clients have expressed discomfort in disclosing details of their performance targets, mostly because they feel it would put them at a competitive disadvantage and that some of the targets may prove difficult for investors to comprehend. For example, targets may not be consistent, for strategic reasons, from budget or prior year results or may differ from the guidance provided over the year to shareholders.



We believe that placing too great an emphasis on the requirements in this area could result in Boards and companies making less appropriate decisions to satisfy external perceptions while not optimizing long-term value creation. For example, this requirement may indirectly result in companies moving from shareholder-friendly performance based awards to non-performance-based awards. We recommend requiring companies to disclose in general terms how targets are set and the level performance achieved compared to the targets set.

6. *Will moving the performance graph to the CD&A and requiring an analysis of the link between the performance of the company's stock and executive compensation provide meaningful disclosure?*

Watson Wyatt favours pay-for-performance analysis. We have been mandated by a number of clients to help them demonstrate the link between compensation and performance. We are concerned that the proposed requirements are too explicitly formulated, which may unintentionally be perceived as an endorsement of methodology or of compensation vehicles by the regulators.

By requiring such analysis with the performance graph, the requirements implicitly endorse total shareholder return as the best available measure of performance, and we believe companies will neglect other pertinent measures in their analysis. We think that relying solely on stock performance is inadequate and our analysis generally includes other measures of performance as deemed appropriate in regards to the industry and other considerations. We agree with the CSA's decision to add comment 1 to section 2.2 of the Proposed Form to clarify that a company may also include other relevant performance measures in its CD&A.

We believe pay-for-performance analysis should be a requirement of the CD&A where companies should demonstrate that the link between pay and compensation existed in the past, and that current compensation warrants that it will continue to exist in the future under all possible scenarios.

### **3. Summary Compensation Table**

7. *Should the summary compensation table continue to require companies to disclose compensation for each of the company's last three fiscal years, or is a shorter period sufficient?*

We believe that disclosing compensation for the last three years is adequate and permits investors to quickly understand the impact of compensation decisions. A shorter period would make those comparisons more difficult, as compensation and employment decisions are often taken during the year.

8. *Do you agree with the way bonuses and non-equity incentive plans will be disclosed in the summary compensation table?*

Watson Wyatt believes that the proposed methodology is artificial and will be confusing to investors who will not be able to truly assess the annual compensation to executives or compare its appropriateness to that of other organizations because of the combination of annual and multi-year plan payouts within the same column.

We do not believe that the split between formulaic and discretionary plans provide additional meaningful information to investors and we believe that the most natural split is between annual



and multi-year plans, corresponding to compensation specialists' and boards' generally-accepted methodologies. In our experience with U.S. disclosure, the separation of bonus and non-equity awards is confusing to issuers. It is often difficult to determine under which category the annual incentive plan fits. There are even instances where the payout from the annual incentive plan is split between the two columns.

We commend the decision to further divide Bonus compensation into separate columns for reporting annual non-equity incentive payouts and non-annual non-equity incentive plans. This will permit investors to better assess the value provided in a year, and separate payouts which are not linked to the prior year.

9. *Do you agree with the proposed disclosure of equity and non-equity awards? Are the distinctions between the types of awards and how they will be presented clearly explained?*

We believe that the proposed rules improve the disclosure of equity awards over the previous regulations and that the distinction between the types of awards seems clear.

The regulations should clarify what is meant by “amounts earned” to be included in column (g) of the Summary Compensation Table. We assume that this would only include amounts which are irrevocably earned by the participant and that have no risk of forfeiture whatsoever. In our experience, it is rare that a cash-based, non-annual incentive plan will actually provide a vested right to payment for an executive until the completion of the multi-year period. Most plans have payout conditional upon the continued tenure by executive. We understand that in such situations, the amount will only be disclosed upon actual payout. We are concerned that under 3.1(5) the proposed disclosure may be construed to require interim reporting of amounts earned (in an accounting sense), where such amounts might never get paid. This could cause negative compensation to be reported in following years. We do concur, however, that interim year accruals should be reported to the extent they become non-forfeitable or otherwise vested, rather than during the year in which accrued.

10. *Is it appropriate to present stock and option awards based on the compensation cost of the awards over the service period? If no, how should these awards be valued?*

We are in agreement with the decision to require companies to base disclosure upon grant date fair value, and believe it provides an adequate summary of the value of the compensation provided.

We also believe that the value disclosed in this manner will generally reflect multiple awards granted in the past (based on the vesting schedule). We are hopeful that disclosing value in this manner will eliminate possible discrepancies in value that may occur when, for example, companies provide special grants (so-called “mega-grants” or “hire grants”).



11. *Should the change in the actuarial value of defined benefit pension plans be attributed to executives as part of the summary compensation table?*

Yes. We also agree that, because of the distortions it would create, it be excluded when determining the NEOs. However, we think that such amount should be net of the contribution made by the executive. We proposed the reporting of the change in the actuarial value, net of the executives' contributions.

We are in favour of the decision to revise the Summary Compensation Table so that only the elements of a change in pension value that are compensatory in nature are to be disclosed. We question the different treatment between defined benefit plan and defined contribution plans in the Summary Compensation Table. We feel that the value under any retirement plan should be reported under column (h). In addition, we suggest reporting the company contributions to a defined contribution plan in column (h) instead of column (i).

12. *Should we include the service cost to the company in the summary compensation table instead of the change in actuarial value or in addition to it?*

We think that both values should be disclosed as both provide valuable information. However, we think that the use of the change in actuarial value is more appropriate in the Summary Compensation Table, as it corresponds to the overall provision for the executive, and that using the change in liability is similar to the treatment of defined contribution plans.

Watson Wyatt believes that the service cost should be disclosed as well (in the retirement plan section) because it provides valuable information as to the design of the plan, which permits investors to clearly understand the value that can be expected from the plan, under normal circumstances.

We recommend disclosing the service cost in the Retirement Plan Benefits section

13. *Have we retained the appropriate threshold for perquisite disclosure given the changes to compensation amounts included in the bonus column of the summary compensation table?*

We believe that thresholds are important to ensure the materiality of information and improve the readability of the circular. We think that maintaining the \$50,000 threshold is appropriate. We believe that the use of 10% of salary as threshold rather than a combination of salary and bonuses will eliminate possible unfair distortions between companies, where companies that offer purely discretionary incentives will be advantaged and have less disclosure requirements, while such discretionary plans are, in our opinion, a less desirable means of compensating executives in a pay-for-performance environment. The removal of the reference to the executive's bonus in the threshold definition will improve the readability of the circular without any significant loss of information.

14. *Should we provide additional guidance on how to identify perquisites?*

No, we believe that most issuers report perquisites adequately.



15. *Will a total compensation number calculated as proposed provide investors with meaningful information about compensation?*

In general, we believe that having a column showing total compensation will improve the transparency to the investors. However, we believe that one issue which is not properly addressed by the proposed regulations is the blend of compensation opportunity (the potential value that is expected) and realized compensation (the value that is actually delivered) and the blend of time frames in the Summary Compensation Table. For example, the equity awards are shown on an annual opportunity value basis, while the non-equity payouts are shown on a realized cumulative basis.

Many Canadian companies have led the way in the past few years by providing separate tables showing total compensation focusing on “today’s” value of compensation that is awarded to executives (which we generally refer to as “compensation opportunity”). These tables were commended for their clarity and tie to the actual compensation decisions made by Boards. We think that the Summary Compensation Table should be adjusted to reflect this best practice.

For non-annual non-equity compensation, we recommend requiring the disclosure of target payout value at the moment of grant, instead of actual amount paid upon payout. We also recommend reporting payouts under these plans in a separate table using the same methodology as for options and stock awards.

16. *Will the disclosure of the grant date fair value of stock and option awards, along with the disclosure provided in the summary compensation table, provide a complete picture of executive compensation?*

The grant date fair value is in line with the methodology generally used by Boards to assess compensation.

We recognize the CSA’s classification of deferred share units (DSUs) as equity-based awards that should be included in the summary compensation table (SCT) in the year of grant. We also appreciate the clarification regarding when incremental fair value of DSUs must be disclosed.

We are also confused by the required disclosure of stock awards under column (g). We believe it would be more appropriate to disclose target payouts (or alternatively maximum payout). We believe that the proposed use of threshold or last fiscal year’s performance will bring confusion and inconsistency year-over-year. Watson Wyatt recommends clarifying the treatment of deferred share units and the reporting of column (g) in the “Outstanding equity based table”.

#### **4. Equity and Plan-based awards**

17. *Is the information a company will provide in the tables required by item 4 the most relevant information for investors? Do you agree with our decision to take a different approach to the SEC? Could material information be missed by this approach?*

We believe that factual information on the individual awards will be missing or difficult to assess, and that reliance on narrative descriptions will reduce transparency. We think that the number of stock or units granted will not be transparently available to the investors, because it will be aggregated in the “Outstanding equity-based awards table” with prior grants. In addition, we believe that reference to “vested” should be clarified.



The Outstanding Equity-Based Awards table should be modified so that stock awards (column (f)) are also detailed on an award-by-award basis. We believe that investors will better understand, together with the narrative description, the compensation element provided to the executives. We do not think that this will bog down the table, as most stock plans in Canada have a life of only three years.

## **5. Retirement plan benefits**

18. *Should we require supplemental tabular disclosure of defined contribution pension plans or other deferred compensation plans? Is a breakdown of the contributions and earnings under these plans necessary to understand the complete compensation picture?*

Watson Wyatt believes it is important for shareholders to understand the value that an executive has available in vested deferred share units. We praise the decision to include a table detailing the defined contribution plans made available to an NEO.

## **6. Termination and change of control benefits**

19. *Should we require estimates of termination payments for all NEOs or just the CEO?*

We believe providing estimates for all NEOs is appropriate especially in situations where the role is split between a chairman and CEO role and a president and COO role. We recognize the value in identifying four standard scenarios (termination, resignation, change of control, and retirement) for the disclosure of termination payments.

20. *Will it be too difficult to provide estimates of potential payments under different termination scenarios? Should we only require an estimate for the largest potential payment to the particular NEO?*

As we consider that it is best practice for companies and Boards to know the value of payments upon termination scenarios, we think that this new requirement is appropriate. We believe it is appropriate to show all scenarios, not just the largest potential payout. The danger of requiring only the largest potential payout is that this particular scenario may correspond to a highly improbable situation. We believe it is important for Board and investors to understand the potential payments under all possible scenarios.

We are concerned that narrative description of the payment may be confusing to investors. Actually more than half of the U.S. issuers have provided a tabular disclosure for similar requirements. Accordingly, the requirements should include a table for reporting termination payments under various scenarios to improve transparency to investors.

We are also concerned that showing an all-inclusive payment value that includes already vested rights may be jumped on by the media which may have the undesired consequence of encouraging executives to reduce that amount by cashing in (or exercising) certain rights, which would be detrimental to the executive ownership mentality. We therefore propose reporting only on the additional payments that are actually triggered by the event and exclude payments that are already available or vested.



## **7. Director Compensation**

21. *Will expanded disclosure of director compensation provide useful information?*

We believe that the proposed table will adequately inform investors. We believe that the mechanics of director compensation will be simplified by companies in the future, with less emphasis on per-meeting fees and more based on the role and responsibilities. We think investors focus should be on total compensation earned, the ties to performance and the mix between cash, shares, options and other vehicles.

## **8. Companies reporting in the United States**

25. *Would the prescription of a performance measurement tool provide useful information on the link between pay and performance?*

We are of the opinion that enforcing one methodology would be counterproductive and would have unintended consequences on plan designs. Watson Wyatt uses a number of different tools, which differ by industry and maturity/business cycle, with adjustments made to adapt to specific realities.

## **9. Transition and other amendments**

26. *Do you think the suggested timeline will give companies enough time to implement these proposed disclosure requirements?*

Disclosure changes of this magnitude (especially the CD&A) will require organizations to prepare multiple draft versions to their Board of Directors for careful review. Compensation Committee's agendas for the end of the year are typically heavily loaded. Such major revisions would be better addressed during the third quarter, requiring companies to start drafting the disclosure in the summer. We anticipate that December 31, 2008 is a feasible date for implementation, provided final regulations are approved by August 31, 2008.

## **10. Additional Comments**

### *Reporting Currency*

The proposed disclosure requires that compensation be reported in the same currency as the financial reporting. We think that this is inadequate and it does not reflect the reality of issuers who have to provide globally competitive compensation. For example, many large Canadian organizations peg executive compensation on U.S. compensation benchmarks to reflect the market in which they are competing for talent. Many of these organizations pay their executives in U.S. currency in order to avoid undesirable impact of changes in the exchange rates. For the same reason, it is appropriate for these organizations to report executive compensation in U.S. dollars, in order to avoid artificial changes from year to year that would only be a reflection of changes in exchange rates.

We recommend allowing issuers to report compensation in the currency of their choice (possibly limited to U.S. and Canadian dollars).



### *Exclusion due to foreign assignment*

We believe that this exclusion should be clarified. It is not clear to us if amounts paid to offset the impact of higher Canadian taxes are to be considered in the determination of the NEOs because of the reference to “overseas locations”. In addition, Watson Wyatt considers that the CSA should consider if any such amounts be reported in the Summary Compensation Table at all, as these do not relate to any advantage received by the executive. We suggest that a footnote specifying the additional amounts paid would provide more pertinent disclosure.

In the determination of the NEOs, we recommend allowing issuers to exclude any cash compensation that is paid in to compensate difference in cost of living (including taxes) between the executive’s base country and the country where the executive works.

In the Summary Compensation Table, we also recommend allowing issuers to exclude any cash compensation that is paid in to compensate the difference in cost of living (including taxes) between the executive’s base country and the country that the executive works.

### *Restatement of amounts*

Guidance should be given on how to handle the restatement of amounts for prior years (e.g. 2005 and 2006), which may be required due to change in the regulations.

### *CD&A Exhaustiveness*

The regulations should require disclosure of the absence of policies which are “deemed material” by the regulations. This would provide better transparency to investors. For example, if a company does not have a policy on compensation clawbacks, this fact should be disclosed.

