

Transparency comes of age for executive compensation

With new disclosure rules, investors will no longer be left in the dark on reasons for padded paycheques

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For **Canaccord Capital Inc.** (TSX, AIM:CCI), fiscal 2007 was a record year for its revenue and profits. With a blistering mergers and acquisitions environment, and bullish stock market, the company profited from the hyperactivity in the corporate finance world.

For the year ending March 31, 2007, the company saw revenue rise 30% to \$756.9 million from \$583.4 million and net income rise 15% to \$93.5 million. Its corporate executives were also paid record amounts, primarily in what the company calls variable compensation.

But if you were to look at exactly how and why Canaccord's senior management were paid the amount they were paid, you'd have a difficult time figuring that out.

While the company states in its management information circular that the compensation is "structured to directly reward merit and links compensation with both individual and company performance," it doesn't provide further detail.

Canaccord's compensation description is not unique, but it illustrates the challenges investors have had to face when trying to gain further details behind executives' annual compensation.

That's about to change.

Starting next year, Canadian companies will have to provide a lot more information and be far more explicit about the rationale

and specifics behind executive compensation.

"It's a fundamental change in compensation disclosure," said **Trevor Scott**, a Vancouver partner at **Farris, Vaughan, Wills and Murphy LLP**.

"One of the things [the regulators] have specifically asked companies to address is each element of compensation.

"We've made a specific point in saying, no matter what we call it, if it's compensation, it has to be there somewhere"

— **Andrew Richardson**, deputy director of corporate finance, B.C. Securities Commission

"That's salary, bonus, options, pension plans; they want companies to identify them and describe why they chose to pay each element and what each element is expected to reward," he said.

These more detailed descriptions will be included in a new component of compensation disclosure: the compensation discussion and analysis (CD&A) section that is analogous to management's discussion and analysis of corporate performance.

Companies will need to include:

- the objectives of the compensation program;



Trevor Scott of Vancouver: "new changes will require [companies] to go into a great deal of description about why their people are getting paid what they're getting"

- what the compensation program is designed to reward;
- each element of compensation;
- why the company chooses to pay each element;
- how the company determines that amount;
- how each element and the company's decisions about each element fits into the company's overall compensation objectives.

Where applicable, companies will also need to clearly state any benchmarks the company uses in determining compensation and also disclose any objective, identifiable targets the company used to determine compensation.

"They're all going to be forced to be very open about it, because for the most part, all these new changes will require them to go into a great deal of description about why their people are getting paid what they're getting," said Scott.

The only exception companies

have is being able to exclude any specific target levels that relate to corporate performance that may "seriously prejudice the company's interests," according to the Canadian Securities Administrators' proposal,

But if a company doesn't disclose the relevant targets, they have to discuss the percentage of an executive's compensation that relate to the undisclosed targets "and how likely it would be for the company to achieve that undisclosed target," said Scott.

These changes have come about in part because executive compensation has changed since the original rules were enacted 15 years ago, said **Andrew Richardson**, deputy director of corporate finance for the **B.C. Securities Commission**. While the cash component was more prominent back then, stock options and restricted share units have become more promin-

ent, which are more difficult for shareholders to value.

The new rules will require companies to place a dollar value on all share-based incentives and also tally the full dollar amount of compensation earned in a year.

It's also including a column to state the value of an executive's pension earned for the year.

"We've made a specific point in saying, no matter what we call it, if it's compensation, it has to be there somewhere," Richardson said.

This comprehensive change is a long time coming and will be good for shareholders, according to **Barry Cook**, an executive compensation expert at **Western Management Consultants**.

"Transparency makes the way organizations spend their money more effective," he said.

These new rules will also likely give shareholders more ammunition to force executives to justify

their compensation in comparison to corporate or share price performance.

"A shareholder can ask any question they want. If you read the agenda for the AGMs for a lot of companies, you'll find that there are activist shareholder groups and individuals that have tried to put a motion that they're going to do all sorts of things to executive pay and management spends a lot of time trying to turn that back," Cook noted.

But these changes are most likely only a starting point.

Said Cook: "I think you're going to see this refined again over the next three to five years, so that a person that picks up one of these disclosure statements can learn an awful lot of information that will be comforting for shareholders to actually know." ■

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