

20 Questions

Directors Should Ask about
Executive Compensation

Elizabeth Greville, LL.B.
David Crawford, CFA



The Canadian Institute
of Chartered Accountants

How to use this publication

Each "20 Questions" publication is designed to be a concise, easy-to-read introduction to an issue of importance to directors. The question format reflects the oversight role of directors which includes asking management - and themselves - tough questions.

The questions are not intended to be a precise checklist, but rather a way to provide insight and stimulate discussion on important topics. In some cases, Boards will not want to ask the questions directly but they may wish to ask management to prepare briefings that address the points raised by the questions.

The comments that accompany the questions provide directors with a basis for critically assessing the answers they get and digging deeper if necessary. The comments summarize current thinking on the issues and the practices of leading organizations. They may not be the best answer for every organization.

Thus, although the questions apply to any organization, the answers will vary according to the size, complexity and sophistication of each individual organization.

Authors

Elizabeth Greville, LL.B.
David Crawford, CFA

Towers Perrin

Project direction by
Gigi Dawe

Principal, Risk Management and Governance, CICA

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Preface

The Risk Management and Governance Board of the Canadian Institute of Chartered Accountants (CICA) has developed this briefing to help members of Boards fulfill their responsibility for the oversight of compensation plans for the executives of their organizations. It is intended primarily to help individual directors, particularly those who are members of compensation committees, but Boards may also wish to use it for orientation and discussion.

The oversight role of a director includes asking management tough questions to assure themselves that compensation plans provide a balance between legitimate shareholder concerns that compensation is strongly tied to performance and management's wish to be well paid. This briefing provides suggested questions for Boards to ask the CEO, senior management, professional advisors – and itself. For each question there is a brief explanatory background and some recommended practices. We hope that directors and CEOs will find it useful in assessing their present approach to the governance of executive compensation and enhancing it where appropriate.

This publication is one of CICA's "20 Questions" series for directors. The text includes a list of the other titles.

The Board acknowledges and thanks the members of the Directors Advisory for their invaluable advice, Elizabeth Greville and David Crawford, the authors, and the CICA staff who provided support to the project.

Frank Barr, FCA

Chair, Risk Management and Governance Board

Risk Management and Governance Board

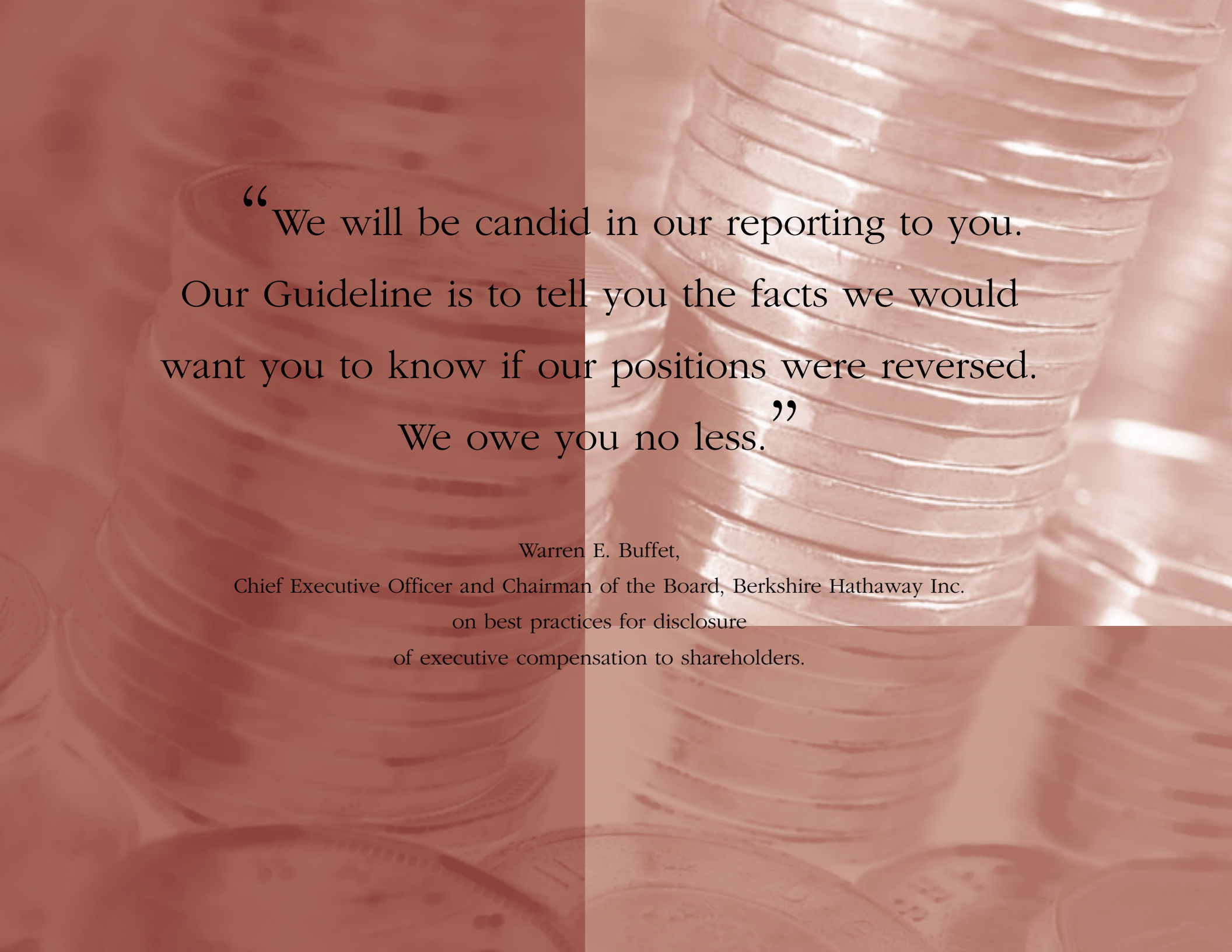
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“We will be candid in our reporting to you.
Our Guideline is to tell you the facts we would
want you to know if our positions were reversed.
We owe you no less.”

Warren E. Buffet,
Chief Executive Officer and Chairman of the Board, Berkshire Hathaway Inc.
on best practices for disclosure
of executive compensation to shareholders.

Directors and Executive Compensation

Corporate scandals, accounting irregularities and shareholder activism have given rise to unprecedented scrutiny of executive compensation and corporate governance.

Shareholder consternation is building over excessive benefits realized from stock options, even as corporate performance languishes and layoffs rise. Not just in North America, but in the UK, Germany and France, shareholders have fought management and won on issues of shareholder value and underperformance. The pressure is mounting on politicians and regulators to act if the corporate community will not. This environment poses major challenges for members of Boards or directors, and in particular for directors who are members of compensation committees. These directors play a critical role in overseeing compensation plans for the company's top executives and are the key link between the Board and management in balancing the interests of shareholders and management.

There are four major risks faced by directors in relation to executive compensation:

- Risk that executive programs will not attract and retain a strong and effective management team;
- Risk that relationship between pay and performance is deficient, encouraging or reinforcing inappropriate executive behaviour or decisions;
- Risk of approving compensation plans that deviate from defensible/optimal "best practices"; and
- Reputational or legal risks if responsibilities are not adequately discharged.

These risks reflect the heightened degree of accountability for directors in making compensation decisions. To manage these risks, the need for informed and well-reasoned Board and compensation committee actions is paramount.

The Questions Directors Should Ask About Executive Compensation

This brochure focuses on three critical building blocks for directors in making compensation decisions:

- Governance structure and processes
- Reasonable understanding of the compensation program design, including the role, level of risk and value of each compensation element, the relationship between pay and performance and range of potential payouts
- Reasonable understanding of the effect of special circumstances (e.g. merger) on executive compensation.

As is often the case in managing or guarding against risks, many of the issues or situations addressed in this brochure relate to exceptional or extreme circumstances.

Governance Structure and Processes

Directors are faced with the essential conflict between the respective interests of shareholders and management. Shareholders want compensation plans that are strongly tied to corporate performance. Management wants to be well-paid and often initially recommends its own compensation levels. Directors must balance legitimate shareholder concerns and the imperative of rewarding and motivating superior management performance.

Board Responsibilities

1. Is it understood where the ultimate responsibility for oversight of executive compensation rests?

2. Are the respective roles of the Board and compensation committee clearly defined and understood?

The Board has ultimate oversight of executive compensation matters. The director's role may be in his or her capacity as:

- A member of the Board, or
- Both a Board member and chair or member of the compensation committee.

Where the Board delegates its compensation oversight obligations to a compensation committee, the committee is generally responsible for overseeing and approving the process and substance of the company's executive compensation program. Regardless of the governance structure chosen, the directors' specific responsibilities include:

- Establishing and overseeing the executive compensation policy;
- Determining the details of the compensation of the CEO, including salaries, bonuses, stock options, other long term incentives, pension, benefits, perquisites and termination compensation;
- Reviewing, amending (if necessary) and approving the CEO's

- compensation recommendations for executive officers; and
- Reviewing performance targets established under the company's incentive programs, assessing techniques for monitoring and measuring performance and determining when performance goals have been achieved.

Establishing Director Independence

3. Are the directors sufficiently independent for purposes of serving on a compensation committee?

Where a committee is in place, its composition, mandate and decision-making processes are critical ingredients in establishing its independence and ability to balance management and shareholder interests.

One of the issues which has been under debate is whether the compensation committee should be comprised entirely of independent directors, and if so, the criteria to be used for determining "independence".

One example of a definition of "independent director" is to be found in governance proposals of the New York Stock Exchange. That definition would require (a) the board of directors affirmatively to determine that the director has no material relationship with the company; (b) a director cannot be regarded as independent until five years after employment with the company has ended; (c) a director cannot have been an employee or affiliate of the company's outside auditor until five years after the end of that employment or affiliation; (d) in the previous five years, the director cannot have been part of an interlocking directorship in which an executive officer of the company serves on the compensation committee of another company that employs the director; and (e) the five-year "cooling off" period applies to directors with immediate family members in the previous categories.

Some observers, including certain investor groups, argue for more stringent definitions of independence, requiring virtually no ties to, or business dealing with, the company. This approach would also have independence determined not by the Board, but by an objective list of criteria. This argument suggests that public perception and trust will be enhanced, and independence ensured, if the ultimate determination is removed from a Board that might be biased and, instead, is based on reference to a disclosed predictable list of criteria which can be objectively verified.

While uniform criteria for all corporations would make determination of independence more obvious and efficient, "checklist" criteria do not take into account qualitative factors. Without a qualitative check, there is risk that in excluding qualified directors from the committee, Boards may be encouraged to seek loopholes or exceptions to the published criteria.

The board of directors is in the best position to make an ultimate evaluation of independence beyond requirements of the law and the stock exchanges, and should develop its own explicit criteria related to independence and/or expertise required for members of the compensation committee. One benchmark is to be found in the TSX Corporate Governance Guidelines, which stipulate that a director is independent of management if he or she is free from any interest and any business or other relationship which could, or could be reasonably perceived to, materially interfere with the director's ability to act with a view to the best interests of the corporation, other than interests and relationships arising from shareholding.

Finally, it is important to note that independence of mind is as important as any objective criteria. Jay Lorsch, a Harvard Business professor who advises companies on corporate governance states: "Independence is a psychological condition as well as a legal one, so you can have directors who are technically independent but don't act that way when they become connected to a Board."*

*Wall Street Journal, "Building a Board that's Independent, Strong and Effective", Nov. 19, 2002.

Independent Advisors

4. **Has the need for independent advice been considered and what is the purpose for which independent advice is required?**
5. **What is the nature of the overall business relationship between the company and management's advisors?**
6. **What is the Board's role in selecting and periodically evaluating advisors?**
7. **Is it clear who (e.g. management and/or advisors) is recommending and/or supporting the reasonableness of the compensation recommendation?**

The independence of outside advisors provides compensation committees with broader and more objective data and perspectives. The ability of the compensation committee to hire and fire outside advisors evidences the independence of the compensation committee, puts the committee firmly in charge of executive compensation policy and management, and reduces the potential for conflicts of interest between the advisors and management.

However, in setting human resource and compensation strategies, management also requires access to outside resources. If directors are consistently hiring their own consultants, the result may be duplicative consulting processes and counterproductive interaction between Board and management advisors, with less company-specific knowledge by each. In addition, the committee will need the benefit of the CEO's expertise and viewpoint on the goals, scope and implementation of the company's executive compensation policy.

The directors should consider the circumstances under which independent advice is sought, and whether it can best be provided through:

- An advisor with no other relationship to the company, or
- Independent access to, and control over, an advisor whose firm provides services to the company's management.

For example, separate and independent advisors may be essential in such circumstances as:

- An unusually adversarial relationship between a company's management and its compensation committee, or
- The belief that either or both of the parties are not acting responsibly (e.g., evidence of self-dealing by management or a lack of attention or independence by the committee).

In other cases, independent access to the company's compensation consultants, to solicit their views and opinions, and to obtain "first hand" any requested data or other information, may be most effective.

There is general consensus that compensation committees should be aware of other business relationships between independent advisors and the company, and periodically assess whether the advisor's independence is impaired by other relationships. Many law firms or compensation consulting firms may have relationships with the company in areas other than executive compensation. While this should not necessarily preclude these firms from providing advice to the compensation committee, such firms should be in a position to report to the compensation committee on the nature and magnitude of other business relationships, and any processes in place to preclude any conflicts of interest. Current business practice is that the responsibility generally then rests with the committee to determine whether the advisor's independence is impaired by other relationships.

It is also important to understand the nature of the advisor's role in a given situation. For instance, the Board might be asked by management to approve a change in the compensation program. The advisors role in the process could vary from recommending the change, to providing advise on a technical aspect of the change, to implementing the change. It is important to clarify who is recommending the change.

Best Practices

8. Is there clear consensus among the company's directors as to best practices and have they been formalized and/or codified?

Commentators have suggested a range of "best practices" for directors and compensation committees in discharging their responsibilities.

An initial checklist could include:

- A strong and independently-minded committee chairperson who manages meeting agendas and establishes regular contact with both management and independent advisors
- Timely dissemination of committee materials in advance of scheduled meetings, and advisor availability to address committee members' questions (one-on-one or collectively) in advance of the meeting
- Regular "executive sessions" without any employees of the corporation for open discussion among the committee members and independent advisors
- Establishment of a regular calendar, including meeting agendas and adequate time allotments
- Interaction with other Board committees (e.g., audit and/or finance) and independent advisors
- Consideration of management proposals - including alternatives that were considered and rejected, and the rationale for rejection
- Annual presentation on trends in executive compensation by independent advisors to discuss broad trends, practices and legislative/regulatory developments
- A formal education process for new members of the committee.
- Holistic presentation of total compensation (e.g., consideration of total compensation package rather than base salary, incentives, equity and benefits/perquisites in isolation)
- Establishment of procedures to ensure that the entire Board has a reasonable understanding of executive compensation
- Report of all committee actions to the full board of directors
- With regard to any action with respect to compensation of the Chief Executive Officer, approval of committee recommendations by the full board of directors.

Disclosure

9. Has responsibility for completing the report on executive compensation for the management proxy circular been explicitly set out in the Board or compensation committee mandate, as applicable?

10. What is the Board's position on broader disclosure and have appropriate policies been disclosed?

Shareholder and market interests are best served through clear and readily understandable disclosure of executive compensation and the economic impact of the compensation.

In its September 2002 Statement on Governance, Values and Competitiveness, the Canadian Council of Chief Executives noted "it is essential for companies to communicate in plain language wherever possible, and to be as open as they can within the constraints of legal and regulatory requirements and of a competitive marketplace."

The Board is ultimately responsible for the report on executive compensation required to be included in the company's management proxy circular.

In discharging this responsibility, it is important for the directors to recognize that regulators, institutional investors and shareholders are seeking full and complete disclosure of all sources and forms of executive compensation, and the company's related underlying policies.

Of particular concern is:

- The process of setting performance goals and objectives for the CEO, evaluating performance relative to the goals and setting the compensation levels based on the evaluation, and
- Complete information on stock options and other stock-based compensation.

In addition to the regular proxy disclosure, broader disclosure policies should be implemented to reassure the public that senior management is not engaged in stock transactions involving the company in advance of material information being available to the public.

For example, the Canadian Council recommends mandatory disclosure of all exercises of stock options and all trades in the company's stock and related derivatives by corporate insiders within two business days. They further recommend that regulators ensure "prompt public distribution" of the information.

Opinion is also growing that companies be required to publicly disclose employment agreements concluded with executive officers promptly following their execution. The disclosure should include a summary in plain English of the significant terms of the agreements.

Finally, it is important that executive pay disclosure in areas outside of the compensation committee's normal mandate is appropriately set out and monitored. This includes financial statements, insider trading, annual reports and shareholder presentations.

Program Design

The Executive Contract

11. Has an independent advisor reviewed the executive contract for reasonableness?

Increasingly, CEOs and other executives have employment contracts covering such items as pay levels, stock option grants, pension enhancements, perquisites, as well as change-of-control and severance agreements.

The contracts could be structured by the executive's agent, by counsel acting strictly as implementers and/or independent advisors. Before the directors approve an executive contract, it is important for them to ensure that the contract is independently reviewed and commented on for reasonableness.

Particular care should be taken in situations where an agent is negotiating a CEO contract absent direct contact with the potential CEO. As leaders and example setters in corporate governance, CEOs should be comfortable that their compensation is consistent with strong governance practice.

Total Remuneration

12. How does the executive's remuneration, in total and by element, compare to the competitive market?

Each organization's executive compensation policy needs to be developed within the context of the overall strategic direction of the company, not as a separate matter developed in relative isolation from the strategic planning sessions of the Board.

Once the policy is in place, the value of the top executive's total remuneration should be periodically assessed versus the competitive reference point. While it is not always critical or practical to place a value on every aspect of remuneration:

- The significant components should be valued versus market; and
- The other components should be commented on, versus the competitive reference points.

Particular care should be given to major changes in executive compensation. For instance, increasing direct pay (salary, bonus and long-term incentives) to a level above the median and/or versus a more aggressive peer group should precipitate a discussion of the appropriateness of the non-direct (e.g., pension and perquisite) compensation.

Monitoring Payments

13. Is there a proper process in place to monitor all payments and other benefits received by executives?

It is important to have policies and/or guidelines in place to ensure the appropriate application and/or use of such items as:

- Car programs
- Company airplanes
- Company purchased or expensed travel and accommodations
- Benefits derived from vendors (e.g., investment bankers)
- Business and/or recreational clubs
- Spousal and family benefits.

The application of these policies or guidelines should also be monitored.

Assessing the Market Competitiveness of Executive Compensation

There is no single "correct" method for evaluating compensation. The first step is a well articulated compensation philosophy that addresses:

- Desired competitive positioning against the market for each compensation element and in total, and
- Desired pay mix (fixed versus variable, short versus long-term compensation, etc.).

Selection of comparator group(s)

14. What factors have been taken into account in comparator group selection? What is the process and timing for reviewing the comparators?

Often the most difficult issues for directors is comparator group selection. In reviewing the comparator companies, relevant characteristics include:

- Geography (National, North American, International): Does the sample reflect geographies from which talent will be recruited, or lost?
- Industry: Is direct industry experience required (may differ by function and level)?
- Size: Does the sample reflect companies with similarly-sized operations or is size otherwise adjusted for?
- Ownership (public vs. private; autonomous vs. subsidiary; founder vs. professional executive): impacts executive positions through accountability, direction received and freedom to act.

Presentation of Data

15. What is the methodology used in presenting the competitive data?

Data can be analyzed in two ways:

- Raw data percentiles, or
- Size-adjusted, generally using single regression analysis to describe the relationship between two variables (e.g. salary and revenue) and help to "predict" compensation.

For executive and senior management positions, it is important to consider both approaches as there is generally a strong correlation between company size and compensation for senior roles.

Elements of Remuneration

Salary

- Ensure that salaries are reasonable, appropriate and defensible, and
- Understand how major changes in salary can drive the compensation and benefits programs. For instance, significant increases in salaries can dramatically change the value of variable pay opportunities, benefit funding and pension values.

Incentive Programs

16. Are the performance measures and standards appropriate?

Is it understood how subjectivity and/or discretion are to be applied in determining the ultimate award?

Does the full range of possible payouts make sense relative to the applicable performance levels and total compensation?

Making decisions to maximize shareholder value can involve complex inter-relationships between maximizing current profitability, optimizing the firm's strategic positioning (e.g., for long-term profitability), financial

and reputational strength. In fact, one of the key jobs of management is to take risks on behalf of shareholders to generate returns commensurate with these underlying risks. Motivating and rewarding success in this context can be difficult.

For many types of businesses, setting measures and standards that can capture success (e.g., value creation) in a given year can be difficult. Financial measures (profitability, EPS, return on equity, cash flow) may lead to inconsistent conclusions. Moreover, annual financial measures often must be traded off against measures relating to long-term strategic positioning (e.g., competitive positioning, productivity, market share / growth, customer satisfaction, etc.). In addition, there are also many measures that may be both important to have in the bonus program, yet may dilute the focus of the incentive (e.g., employee safety, environment, credit rating).

The degree to which incentives motivate action largely depends on both the incentive structure and the management team involved. For some executives, maximizing their incentive pay is a critical consideration behind decisions. This is not necessarily good or bad, it just needs to be understood. Maximizing individual bonuses cannot always be perfectly aligned to maximizing company success. There have been many debates over how objective or formula-driven a bonus plan should be, versus a more subjective or discretionary approach. There is a risk that awards based on a single measure (e.g., profit based) can be maximized through short-term actions that will not result in sustainable value added. Conversely, a formula bonus rewarding on a multiplicity of measures can lack focus.

In the end, what is most important is to understand and be comfortable with:

- What the bonus program is rewarding, and what may be missing;
- The effectiveness of the program to incent, focus and/or reward strong performance;

- The full range of possible performance levels and resulting formula payouts (not just expected pay for expected performance); and
- The related costs of the program.

Stock Options

17. Does the design and size of option awards make sense in light of the inherent strengths and weaknesses of the program as well as competitive practice?

Should there be guidelines governing how and when options should be exercised and/or acquired shares should be sold?

Stock options have increased dramatically in both prevalence and quantum over the last ten years. They have been singled out as factors in both shareholder successes and shareholder failures.

There are a number of competing issues to be considered when dealing with stock options:

- They reward for the increase in share price – an objective and external measure of the company value. In fact, one of the original objectives of stock options was to address the criticism that too often executives were being overpaid for increasing EPS and ROE, even though shareholder value was not being maximized. Facing significant pressure to maximize shareholder value, Boards turned to stock options as the safest and most effective approach to reward executive performance;
- They are very tax effective for participants. Only half the option gain is taxed as regular income; and
- Options are difficult to replace from a competitive pay point of view.

Yet,

- The competitive granting levels have increased dramatically over the last ten years. In many cases, the high number of options, combined with the volatility of the stock price, have resulted in significant motivation to produce strong short term results or built-up expectations:

- To obtain significant rewards for increasing the share price, or
- To maintain the stock options' in-the-money position;
- Options generally fail to create shareholders ("the act of exercising is normally the act of selling"). Often the shares acquired on exercise are immediately sold to finance the exercise price and taxes on the gain, and to lock-in the gain; and
- There have been many examples of option gains in situations where the underlying share prices were not sustained.

In assessing stock options, it is critical to:

- Consider alternative or complementary forms of long-term incentives (and understand the strengths and weaknesses of each);
- Understand both the competitive positioning of long-term incentive programs, and the expected and possible future wealth scenarios that could be generated; and,
- Consider possible ways that the stock option design itself could be improved. For example:
 - Longer and/or tougher vesting
 - Ensuring the gain is based on longer-term shareholder value (e.g., require part of gain to be held in trust)
 - Requiring part of the shares acquired on option gain to be held in trust, particularly where the gain is significant
 - Review change-of-control provisions to ensure appropriateness.

Share Ownership

18. Are there appropriate rules and guidelines in place with respect to share ownership and share related transactions?

Share ownership is a critical component of the executive rewards program. There are several approaches for achieving appropriate share ownership levels: mandating, facilitating as a normal part of a pay program and/or incenting share ownership. One of the trade-offs to be made is between the desire of the executive to diversify and the desire of the shareholder for executive alignment through substantial ownership. It is useful to consider the level of executive ownership in relation to the wealth the executive has realized from company

programs (in particular, long-term incentive payouts). The greater the wealth creation, the higher the ownership level should be.

Executive shareholder loans have faced significant scrutiny of late. In the US, company loans are ostensibly prohibited under the Sarbanes-Oxley Act.

Significant shareholder loans have faced various criticisms, including:

- Leveraged loans can create dysfunctional behaviour when market price falls;
- Companies will ultimately "bail out" executives anyway; and
- Loans provide too lucrative a benefit.

Many who advocate leveraged loans argue that these arrangements align management and shareholder interests better than stock options.

If loans are to be used, they should ideally be set up to ensure that there is a very high probability that the market value of the underlying shares is greater than the loan. One design approach is to ensure there is an appropriate equity cushion above the loan amount when the loan is made. Any preferential loan features should be valued and incorporated as part of total compensation.

Finally, it is important to note that stock options themselves have an embedded interest free loan feature - option holders are granted the right to buy shares at today's price up until the expiry date.

Share Transactions and Hedging

In the past, insider trading and disclosure requirements have resulted in either very slow and/or no public disclosure of executive share and share related transactions. The expectation is that this process will be much more transparent going forward.

It is important that the Board not only ensure that the spirit of the insider trading rules be followed, but satisfy itself that share transactions are appropriate:

- Under what circumstances is it appropriate for an executive to sell shares in the company?

- What rules should be in place to govern the use of financial instruments to change the risk/reward characteristics of ownership or option positions (e.g., hedging instrument executives can buy to remove the downside risks of executive share ownership)?

Pensions and Post-Retirement Benefits

19. Do we understand and are we comfortable with the pension and post-retirement benefits the executive is entitled to over time?

Significant compensation can be derived from executive pension and post-retirement benefits. It is not unusual to see extra credited service and/or enriched formulae in the CEO's pension. This is an area where seemingly small changes to the pension can add significant compensation value (cost). It is important to understand the manner in which pensions grow in value and become payable in a range of termination and retirement scenarios. For instance, would the accumulated pension amounts be reduced or unreduced, and are the pension payments immediate or deferred (e.g., is an immediate unreduced pension payable at 55?)?

Benefits and Perquisites

These elements of remuneration should be periodically reviewed to:

- Validate the business need, particularly for perquisites such as company jets, cars and club memberships, and
- Confirm overall market competitiveness.

Effect Of Special Circumstances On Executive Compensation

The previous section examines the specific components of compensation. This section considers how special circumstances affect executive compensation.

20. Does the Board understand and feel comfortable with compensation that may be payable in special circumstances such as change-of-control?

Change-of-Control

Change-of-control provisions enable executives to focus on the goal of maximizing shareholder value without being concerned with their future role in the company. These provisions can be incorporated within various elements of the compensation program (e.g., stock options, pensions, benefits, etc.). They can also be found in executive contracts, or as part of a separate policy.

Key elements of change-of-control arrangements include:

- *Triggering mechanism*
 - Most common approach is a "double trigger" requiring both a change-of-control to take place and the executive to be terminated (including constructive termination)
 - A "single trigger" requires only a change-of-control to take place
 - A "modified single trigger" requires the executive to remain with the surviving company for a specified period following a change-in-control to ensure successful transition.
- *Change of control definition.* A "multi-part" definition is typical and may include:
 - the acquisition of a certain portion of the common shares or assets of the company; major change in the composition of the Board; shareholder approved merger or consolidation; and/or discretionary determination by the Board.

Perhaps too often, a change of control definition gets triggered, even though nothing has fundamentally changed with the company.

- *Programs /Payment features*
 - Stock options. Options normally vest on a single trigger. This is perhaps one area where common practice is inconsistent with the main intent of change of control. Too often options vest on a change-in-control even though there is a surviving public

company and management's current role is maintained, if not enhanced.

- Severance payments. Normally a top executive will receive payments of two or three years' worth of salary and target bonus. Benefits and perquisites may also continue. In a few situations, compensation in consideration of foregone future long-term incentive award opportunities (e.g., future stock option grants) are included. Care should be taken that the Board clearly understands and is satisfied with the resulting remuneration.

Executive Severance

Severance agreements take several forms. Some are contained in employment contracts, some are stand alone general purpose severance agreements and some only apply in a change-of-control situation.

The issues discussed above under change-of-control are equally important in the severance context.

Conclusion

The continuing challenge confronting directors is to ensure that the company's executive team is properly motivated and rewarded to achieve expected or planned values. If this is done in an appropriate and conscious manner, the risk of overpayment or underpayment to management is significantly minimized. The key issue is for directors to determine, rationalize and be satisfied that they can defend the results.

In essence, what is a fair portion of the wealth created to be awarded? This hits at the very heart of the dilution of equity issue troubling some of the major institutional shareholder groups - an issue that is likely to continue to be a hotly debated topic.

Our comments are primarily relevant to publicly traded companies. However, while good governance practices may take different forms in privately held companies, the underlying principles and values are equally important to the success of all enterprises.

Where to find more information

Canadian Institute of Chartered Accountants publications, The 20 Questions series

20 Questions Directors Should Ask about Executive Compensation

20 Questions Directors Should Ask about IT

20 Questions Directors Should Ask about Management's Discussion and Analysis

20 Questions Directors Should Ask about Privacy

20 Questions Directors Should Ask about Risk

20 Questions Directors Should Ask about Strategy

Other CICA publications on governance, strategy and risk

CA/CPA Performance View.

Guidance on Control, 1995.

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Governance, Values and Competitiveness

A Commitment to Leadership. A Statement of the Canadian Council of Chief Executives,
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About the authors

Elizabeth Greville is a Principal and leader of the executive compensation practice in Towers Perrin's Toronto office. She has over 15 years' experience in Canada and the UK consulting to management and Boards on the design and implementation of executive compensation programs. Her practice covers publicly traded companies across industry sectors as well as stock/incentive plan designs for special situations such as IPOs and private organizations.

David Crawford is a Principal in the executive compensation practice of Towers Perrin in Toronto. He has consulted on executive compensation issues for eleven years. A significant portion of his time is spent working with clients in the areas of stock-based compensation, incentive plan design and performance measurement.

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277 Wellington Street West
Toronto, ON. Canada
M5V 3H2
Tel: 416-204-3280
Fax: 416-204-3340
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