CFOs – More Important Than Ever!

New CSA Disclosure Rules – CFOs Have an Expanded Role

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Key Features - New CSA Disclosure Rules

- The 2nd CSA proposal has significant changes from the 1st draft
  - Summary Comp Table (SCT) will show compensation fair market value of equity awards granted that year
    - Different from current rule, which shows number of stock options and might show number of whole shares (unless they are shown in a table with threshold, target and maximum
    - Different from SEC rule, which shows accounting expense per executive in a given year of all outstanding grants (CSA's 1st draft mirrored SEC)

FMV of Equity Grant in SCT

- Why this is a victory
  - Readers will understand the value of the total package the board intended to provide
  - Better comparability from company to company, at least within Canada
- Note for CFOs
  - Compensation value might differ from accounting fair value of new grants, differences must be footnoted
  - Understand methodology inputs (e.g., expected term vs. full term)
  - Do not force compensation value to match accounting value
    - More important to be consistent with comp surveys
    - Purpose is theoretical value at grant, different from accounting purpose to match likely actual exercise pattern
    - Sr. exec exercise patterns differ from overall population
  - Do not look at US peer SCTs and assume they mean anything!

Key Features - New CSA Disclosure Rules

- Significant changes continued
  - Summary Comp Table (SCT) will not separate annual bonus into "good bonus" and "bad bonus"
    - SEC has "good bonus" = quantitative award vs. "bad bonus" = discretionary award
    - A key change from CSA's 1st draft
    - Means annual incentive/bonus is shown in one column, whether it has a discretionary component or is totally quantitative (and multi-year cash plans are not muddied by being included with quantitative annual incentive)
    - A triumph of practicality

Key Features - New CSA Disclosure Rules

- Significant changes continued
  - Pension values must be included in the SCT
    - 2nd draft requires reporting of Defined Benefit and Defined Contribution plans in one column
    - Must show changes due to compensatory factors only (e.g. impact of salary increase, annual bonus, another year's service) not change in actuarial value as originally proposed
  - Note for CFOs
    - Some of the underlying actuarial assumptions used in financial statement footnotes likely will not apply to single incumbent reporting (e.g. age, gender, service)
    - Some assumptions still unclear (e.g., assume future salary increases or just compensation "earned to date")
    - Will need individual calculations for all possible NEOs (which might change from year to year and is to be calculated on TDC excluding pension value, not TCC as currently)

Key Features - New CSA Disclosure Rules

- Disclosure of contractual termination values
  - Upon retirement (if eligible), voluntary termination, involuntary termination, voluntary and involuntary termination following a Change in Control
    - Have clarified is only the incremental, contractual value, e.g., not already vested option gains or DSUs
  - Note for CFOs
    - Legal and HR should understand the plan documents
    - Detailed calculations may need to be calculated or checked by finance, since values are significant and calculations are complex

Key Features - New CSA Disclosure Rules

- Single most important area where CFOs will need to help HR and Legal – is the new Compensation Disclosure & Analysis (CD&A)
- Single area most likely to give CFOs heartburn – CD&A
- CSA, similar to SEC, will require much clearer disclosure in CD&A of
  - Performance measures
  - Performance metrics (threshold, target, and maximum)
  - Achievement vs. metric
  - Calculation of STIP, and LTIP awards if appropriate

CD&A Performance Measure Disclosure

- Institutional investors want disclosure of forward looking targets for incentive plans
- Note for CFOs - beyond heartburn into ulcers
  - How do threshold, target and maximums match with
    - The Street's expectations
    - Formal guidance, if provided
  - Do they amount to guidance?
  - Does their disclosure amount to commercial harm?
    - What if your competitors disclose theirs?
  - As a participant you might enjoy achievable targets, as a CFO you might want tougher goals disclosed

CD&A Performance Measure Disclosure

- Unintended consequences
  - Disclosure should not change plan design
  - Incentive plans should reinforce business strategy
  - Plans that pay vs. budget will now reveal budget
    - Does this mean that super stretch budgets will disappear, so that payment for good performance will not have to be explained?
    - Does this mean that STIP and LTIP performance will reflect less sensitive but less important, or more controllable, measures or easier targets?
- Note for CFOs
  - Incentives are an important tool to help the CEO direct the company and achieve desired success, don't let your concerns about disclosure diminish the importance of this tool

On a Personal Note . . .

- Should CFOs or some of your team have a different pay package?
  - If incentive plans pay against budget and you set most of the budget, should you be excluded?
  - If not you, should the Controller, Internal Audit?
  - Would the drive to succeed be lost/diminished?
  - Would the company's performance be less?
  - Does this reduce you to "bean counters" not financial architects and key business strategists?
  - Could you skip the STIP and have greater LTIP with clear long-term value creation?
    - If so, with how much leverage?

Thank you for your attention

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