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Compensation Committee Analysis 2001-2010

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TEACHERS' PENSION PLAN
ONTARIO

| May 2011

Executive compensation has been and continues to be a top concern for the public, regulators and shareholders. Exorbitant bonuses were identified as partly to blame for the risks taken by executives that ultimately lead to the economic down-turn in 2009, considered by some top economists as the worst financial crisis since the great depression of the 1930s.[1] As a result, Compensation Committees have been re-examining their mandates, composition and internal processes. The increased scrutiny from the media, shareholders and the public has applied more pressure on Compensation Committees to align processes with best practices. Compensation Committees are being called upon for direct involvement and accountability with respect to executive compensation decisions.[2] This article examines trends we have identified among Compensation Committees of corporations that were listed on the S&P/TSX Composite Index during the decade of September 1, 2001 to August 31, 2010, relating to changes in committee member tenure, size and composition and annual Chair retainers.

Committee Member Tenure

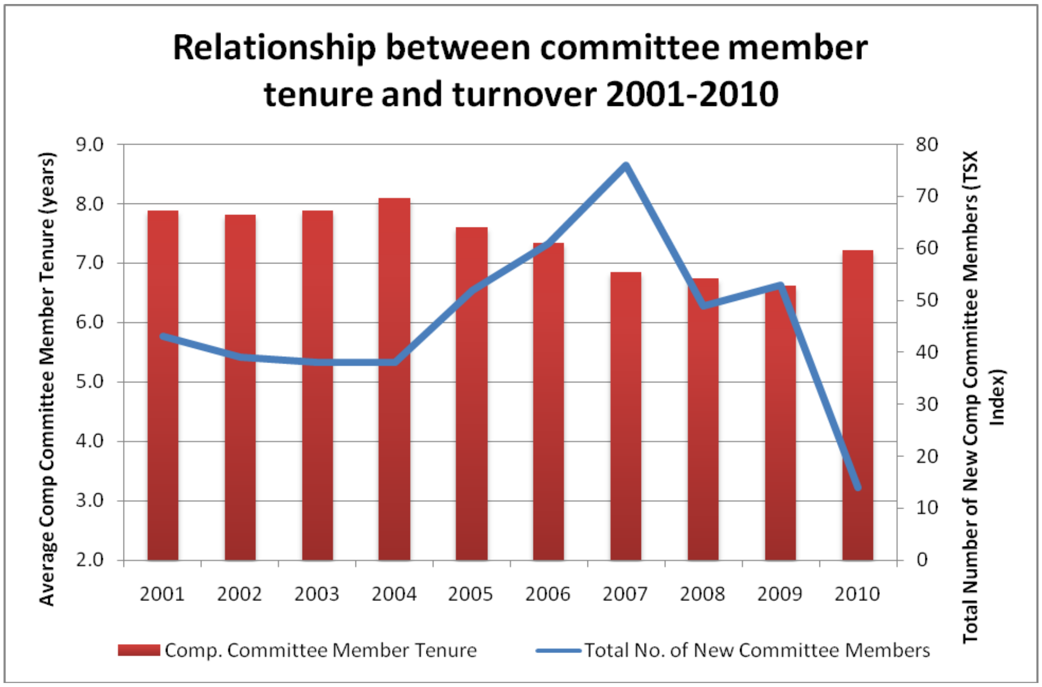
The tenure of compensation committee members among S&P/TSX Composite Index boards has decreased during the period of 2001-2010 from 8 years to 7 (**Figure 1**). Compensation committee tenure reached a high of just over 8 years in 2004, and a low of about 6.5 years in 2009 – a decrease of 18%. In 2010, however, average compensation committee member tenure has increased again to over 7 years of service, a level not seen since 2006.

In 2010, we saw the fewest new members elected to compensation committees of any year during our observation period of 2001-2010. This drop in committee member turnover explains the increase in tenure described above.

[1] "Three Top Economists Agree 2009 Worst Financial Crisis Since Great Depression; Risks Increase If Right Steps Are Not Taken." Reuters 29 Feb 2009. Web. 27 Apr 2011.

[2] Hugessen Consulting Inc. "Chair of the Compensation Committee: Evolution of the Role" May 2010. Web. 27 Apr 2011.

Figure 1.



Size and Composition

Compensation Proficiency Among Committee Members

In 2007, CCBE began identifying directors who have significant experience with executive compensation. In order for a director to be recognized as a compensation proficient member, we require that they have a minimum of 5 years' experience as either an executive with responsibility for compensation oversight or a Compensation Committee member of a public company whose market cap is at least $100 million.

The number of new compensation committee members in 2010 is relatively small: 14, compared to 53 in 2009 (**Figure 2**). However, new compensation proficient members represent a little more than 31% of new members. In each of 2009 and 2010, compensation proficient members in our sample have an average committee tenure of a little more than 9 years. This is significantly higher than other compensation committee member tenure for the S&P/TSX Composite Index of a little less than 2.5 years. The average tenure of a Compensation Committee member from 2009 to 2010 is well over the minimum of 5 years experience needed on a Compensation Committee, as per the CCBE criteria, for a member to be considered compensation proficient. As a result, the average compensation committee comprises 73% compensation proficient members.

Figure 2.

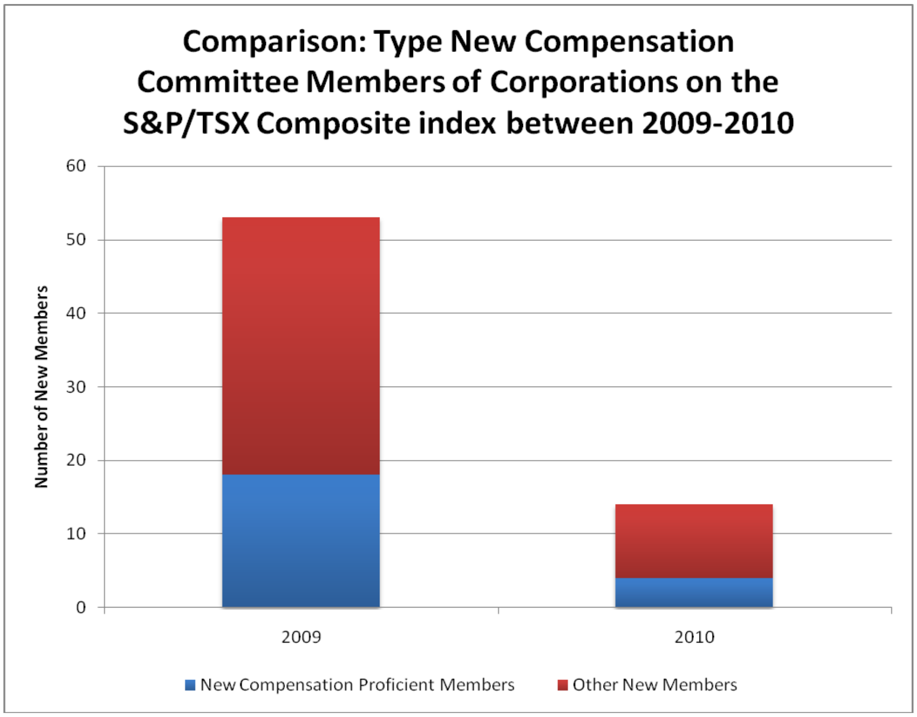
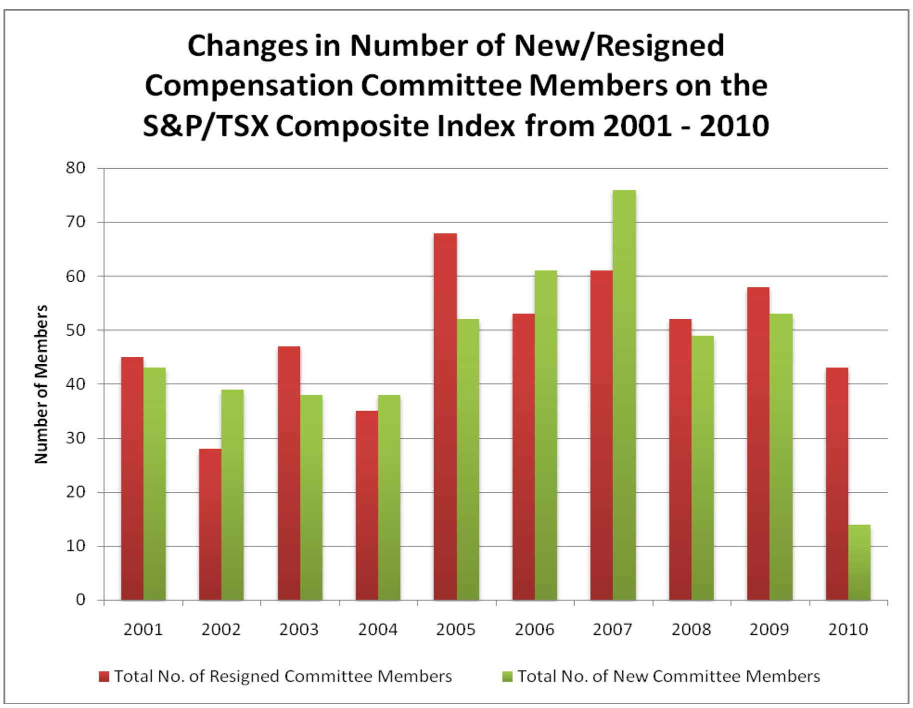


Figure 3.



Compensation Committee Size and Turnover

Compensation Committees have changed only modestly in size and composition since 2001. During the period of 2001-2010 the average size of S&P/TSX Composite Index Compensation Committees has seen modest fluctuations between 4 and 4.5 members. In 2002 and 2007, average compensation committee size was the same, a little less than 4.5 members at its' largest. In 2010, compensation committees are the smallest they've been since 2001, at an average of a little more than 4 members. In 2007, the renewal rate of resigning compensation committee members on the S&P/TSX Composite Index was 125% (**Figure 3**), as a result, the average committee size experienced its' largest growth that year. However, in the three year period from 2008 to 2010, the trend reversed, with more members leaving Committees than joining them. In 2010, the average committee size shrank by 33%.

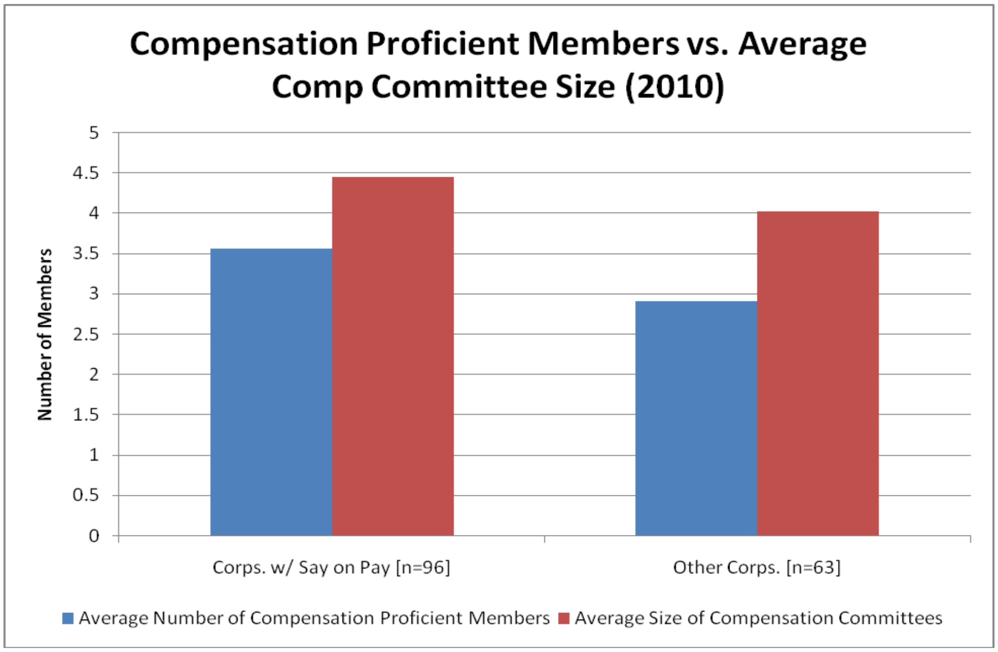
Say on Pay

Advisory votes on executive compensation, known as 'Say on Pay', are a relatively new global shareholder engagement policy. Regulatory bodies in the UK and US have mandated Say on Pay since 2002 and 2010 respectively. Currently, Canada has not legislated Say on Pay, however 17% of the 199 corporations listed on the S&P/TSX Composite Index in 2010 had introduced Say on Pay voluntarily which is an increase from 8% of 157 corporations in 2009. Say on Pay increases pressure on Compensation Committees to maintain appropriate pay-for-performance alignment with emphasis on long-term shareholder value and alignment of internal processes to best practices.

Say on Pay has been met with only fair support in Canada, directors and regulators are not convinced it is the best way to deter Boards from paying inappropriate bonuses that do not align pay and performance.[3] Corporations listed on the S&P/TSX Composite Index as of July 1st, 2010 that adopted Say on Pay have an average Compensation Committee size of 4.44 members; a little larger than other corporations (**Figure 4**). The average number of compensation proficient members (3.56) on the compensation committees of corporations with Say on Pay is 1.2 times greater than other corporations. Also, among corporations with Say on Pay, 80% of compensation committee members are compensation proficient, compared to 72% on other corporations. As a result, a Board may feel better equipped to address shareholder concerns with a relatively large compensation committee comprising mostly compensation proficient members.

[3] Schechter, Barbara. "OSC Ponders Mandatory Say-on-pay Rules." Financial Post 10 Jan 2011. Web. 3 May 2011.

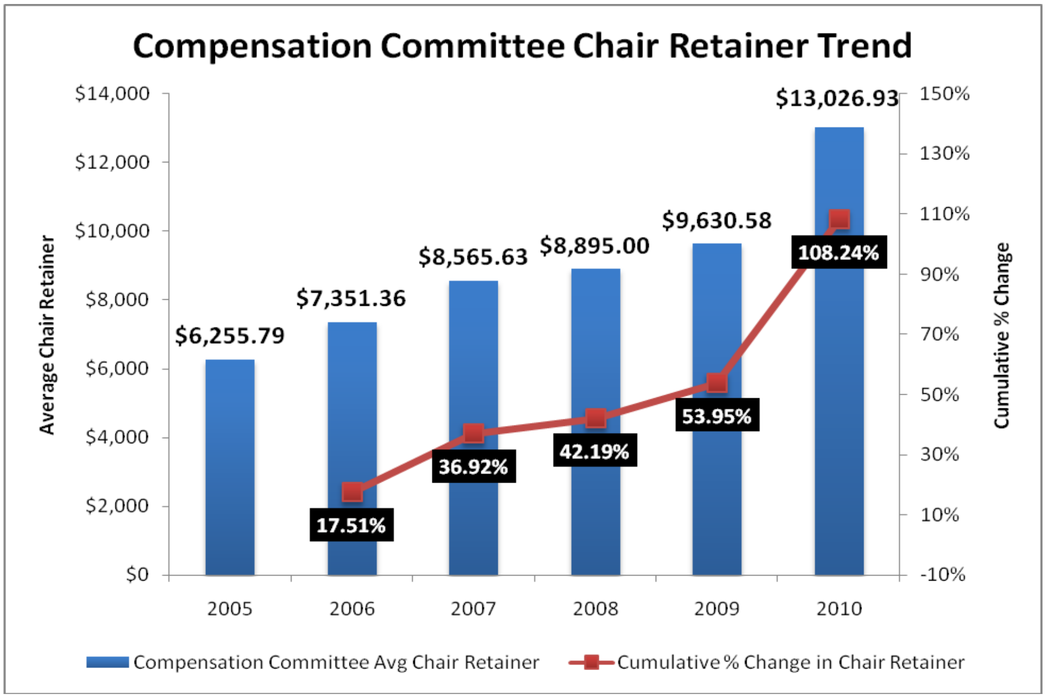
Figure 4.



Annual Compensation Committee Chair Retainer

As a result of increased outside pressure in the wake of the financial crisis, it is more critical than ever for Boards to attract and retain an effective Compensation Committee Chair. The average annual Board retainer in 2010, including cash and deferred share units (DSU), was $105,341.60 - an increase of 86.5% since 2005 (**Figure 5**). Compensation Committee Chair retainers have seen an even more substantial increase of 108.4% since 2005. In 2010, the average annual Compensation Committee Chair retainer ($13,027) increased just over 35% from $9,630 in 2009. However, regardless of rapid pay increases for Compensation Committee Chairs; their average retainer is still only 61% of average Audit Committee Chairs, whose pay increased following new regulations in the early 2000s.

Figure 5.



Conclusion

Following the recent financial crisis, boards faced increased scrutiny on executive compensation from investors, regulators and media. Compensation Committees are currently under pressure to align internal processes with best practices. In 2009, Canadian boards responded quickly by recruiting a large number of compensation experts to their Compensation Committees and increasing the retainers paid to Committee Chairs. Firms that have voluntarily adopted Say on Pay have shown even greater initiative, further ensuring that their boards are equipped to effectively oversee executive